101th Congress
2d Session

COMMITTEE PRINT

S. PRT.
101-106

WORKSHOP ON U.S.-U.S.S.R. COMMERCIAL RELATIONS

April 17, 1989

A REPORT

TO THE

COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE

BY THE

CONGRESSIONAL RESEARCH SERVICE
LIBRARY OF CONGRESS

JUNE 1990

Printed for the use of the Committee on Foreign Relations

U.S. GOVERNMENT PRINTING OFFICE

97-580 ⇆ WASHINGTON : 1990

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, DC 20402

S382-24

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LETTER OF TRANSMITTAL

MAY 16, 1990.

Senator CLAIBORNE PELL,
Chairman, Committee on Foreign Relations,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: In response to your request, the Congressional Research Service held a Workshop on U.S.-U.S.S.R. Commercial Relations. Attached is the report on that workshop that includes the presentations and discussion by participants, additional materials submitted for the record, and an introductory paper outlining a framework to provide central questions and guide the discussions.

Given the current negotiations on a U.S.-Soviet trade agreement, expected to be signed in the very near future, this report is particularly timely. While the events occurring in what used to be called the Soviet Bloc have moved more rapidly than we all expected since the workshop, the assessments of the issues covered have proven valid and should assist the Committee, and other interested parties, as the trade agreement is assessed, and other commercial treaties to be referred to your committee are negotiated.

Sincerely,

JOSEPH E. ROSS,
Director, Congressional Research Service.

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PREFACE

The Senate Foreign Relations Committee asked CRS to organize a workshop to address the issues of commercial relations between the United States and the Soviet Union. The workshop was organized into four panels each dealing with a particular issue. The overarching framework of policy is addressed by the first two panels on United States-Soviet Bilateral Relations and Alliance Relations as they establish the environment for policies of commercial facilitation or restriction. The third panel addressed specific commercial issues such as trade credits, imports, exports, and joint ventures. The fourth panel discussed alternative outcomes for the United States-Soviet relationship.

In the Introduction we have sought to frame the critical policy issues and provide central questions to guide and shape the dialogue. With prospects for trade and investment treaties being completed in the near future, it is appropriate to examine the issues involved in expanded commercial relations. The discussion by the participants is followed by an appendix which includes supporting papers and documents supplied for the workshop record.

INTRODUCTION

A Framework for Assessing United States-Soviet Commercial Relations

Perestroika holds out the prospect of the emergence of a qualitatively new phase in Soviet history. It represents the first program which both identifies the failures of the Soviet politico-economic and strategic model and conceptualizes a view of a future Soviet socialist state which has market-oriented, participative, and pluralistic underpinnings. To a large extent, the first years of perestroika, glasnost, and democratization have consisted of a deliberate process of removing old obstacles and laying the foundations for future change, both domestically and internationally.

Perestroika, glasnost, and democratization represent the outline of a gradually evolving plan for long-term transformation of Soviet society through the modernization of obsolete plants, economic reform, increased openness, democratization of the political process, and a quickening of pace to address Soviet competitiveness concerns. Modernization is to allow for increased quality and quantity of output through intensive high technology investment. Economic reform evolves out of a growing Soviet recognition that high technology inputs in and of themselves would be quickly outmoded by new technology and that in fact systemic change is required. Economic reform is to include complete financial autonomy of Soviet enterprises; a shift from micromanagement of the economy by central planners and ministerial bureaucrats to guidance planning through macroeconomic levers; increased reliance on prices; reliance on market forces for the allocation of resources and incentives. As economics and politics are inherently interrelated in command economies, Soviet reformers have proposed and carried out a series of political reforms (including elections contested by more than one candidate per office and non-Communist candidates) aimed at breaking the strength of the antireformers located throughout the bureaucracy.

Perestroika may be considered a response to the deep "precrisis" situation which the Soviet leadership faces domestically: (i) The domestic economy cannot satisfactorily meet even some basic needs of the Soviet population with regard to food, medical care, or housing—despite the spending of 20 percent of the state budget on consumer subsidies. (ii) Moreover, the trends toward declining growth in labor and capital productivity suggests future Soviet inability to attain higher standards of living. Official support for long-term "radical" change may derive from a perceived need to improve and ensure the central role of the communist party in the Soviet Union. Within a new framework, this means that the Soviet lead-

ers may well seek to relegitimize the regime by creating opportunity to those who desire it and quality consumer goods for all.

"New thinking" represents Soviet admission of failure of the decades-long policy of pursuing military superiority and a foreign policy based on military force or the threat of force. In addition to effectively announcing a departure from past policies, the Soviets are advertising "new" policies: first, the adoption of Western standards in arms control, regional conflicts, human rights, and economics; and second, the adoption of a multilateral framework through greater reliance on international organizations and greater participation with newly recognized global economic powers in Europe and Asia. "New thinking" has also translated into proposals to direct future international relations according to the following tenets: global politico-economic and strategic relations are to be based on greater interdependence; national security depends on mutual security of international players; and actively pursuing a policy of reasonable sufficiency.

There is no reason to assume that the Soviet Union does not desire continued or growing influence abroad. Within the framework of new thinking, however, the means to those ends could influence the extent of cooperation or conflict with the West as the Soviet Union pursues its global objectives. Soviet leaders have stated that their new goals include: full membership in the world community including political and diplomatic leadership, economic integration, global competitiveness. The Soviets want all nations to play by the "internationally accepted" rules. They want to effectively end the politics of "inclusion" and "exclusion." Much of this thrust is directed at the United States.

Systemic change, particularly in a system that has traditionally been static, is a daunting process. Western Sovietologists frequently refer to the process of change as "opening Pandora's box" or of "letting the genie out of the bottle"—evoking a sense that the dynamics of change will push reform much further than originally intended and that reversing course might be impossible. On the other hand, the contents of a "Pandora's box" might prove so unacceptable to the party that it could lead to an attempt to halt or even reverse many of the reforms. Some foresee serious dangers including threats to national cohesion and public order. Many of the specifics of reform remain unspecified and the direction of change is unpredictable. Thus, careful consideration of the theoretical underpinnings and practical steps made is critical to formulation a U.S. response.

Uncertainties concerning the direction and outcome of present and future Soviet reform efforts are considerable, making predictions both risky and questionable. Policymakers would, at this point, take high risks in assuming that Soviet perestroika ultimately turns in favor of the West. Faulty assumptions could leave the West open to unnecessary security risks. Excessive pessimism could prevent Western policymakers from identifying and encouraging favorable Soviet developments—both domestically and internationally. The West neither wants to be in a position of giving away too much too soon nor of losing opportunities while waiting to evaluate the reform process. Therefore, the United States and the Western

nations need to re-assess and define policy criteria with which to assess the evolving nature of Soviet reform and global trends.

Questions

1. Is the long-term success of Soviet economic revitalization in the U.S. interest? What are the potential risks and benefits?
2. What is the likelihood of sustainability of reform and success of Gorbachev's policy? How do we assess the creditworthiness of perestroika?
3. Can and should the United States seek to influence the outcome of perestroika, democratization and "new thinking"? If so, how may we be most effective in accomplishing such goals?

UNITED STATES-SOVIET BILATERAL RELATIONS

Traditionally, U.S. policymakers dealing with the Soviet Union have been most concerned with issues of international security and human rights, and have placed economic concerns—that is, normal and stable bilateral commercial relations—in the category of derivative importance. In the current context of a changing global economy, and the rise of conflicting trends of globalism and regionalism, some of the old concepts are being challenged and policies accepted throughout the post World War II era are being reassessed. In the Soviet Union, this has taken the form of perestroika, glasnost and democratization at home and "new thinking" internationally. Since 1985, a cautious reengagement of United States-Soviet bilateral relations has taken place. The summit process has provided a forum for negotiating a larger superpower political agenda covering arms control, regional issues, and human rights concerns. Some would say that the Bush Administration is now pursuing a "wait and see" policy, but this is not conceded, nor does it support prediction of future action.

Questions

1. Have these improvements in the major issues on the United States-Soviet bilateral agenda led to a qualitative change in the overall relationship?
2. Is the process of negotiation in arms control, regional issues, and human rights sufficiently favorable to provide a basis for a policy of commercial facilitation?

ARMS CONTROL

The Soviet Union surprised the West by agreeing to provisions of the INF treaty which included a global double-zero and intrusive monitoring. In line with its newly espoused doctrine of reasonable sufficiency, the Soviet Union has agreed to negotiate a reduction of strategic nuclear forces (a START agreement, portions of which may be ready to sign by June 1990), asymmetrical reductions of its conventional forces in Europe (CFE), and , in a show of good faith, has announced and accomplished some unilateral force reductions-including the withdrawal of six tank divisions from Eastern Europe.

Questions

1. Has the arms control process proceeded to the point where a qualitative change has been reached and a firm process of arms negotiations set in place?
2. Does the Soviet defense burden link security and economics in a manner useful to U.S. interests? Is the political success of Gorbachev's perestroika in conflict with the traditional view of defense needs?
3. Will the Soviets follow through on what they have promised in arms reductions and verification?
4. Will Soviet force changes and reductions permit them to press for a denuclearized Europe? How will this effect our ties with our allies?

REGIONAL ISSUES

In a dramatic policy reversal, the Soviet Union agreed to the U.N. Geneva Settlement on Afghanistan and completed a total withdrawal from Afghanistan on schedule. Moscow has also actively supported "national settlements" in Angola and Cambodia, (and passively allowed a settlement in Nicaragua) that allow for the withdrawal of its clients' forces (Cuba and Vietnam). These Soviet actions in the Third World seem to indicate that the present Soviet leadership is reassessing its Third World policies based on both political and economic considerations (rather than on the basis of an ideology of world revolution). Thus, it appears that "adventurism" and intervention in the Third World has lost considerable ground as a Soviet priority. As it focuses on domestic restructuring, the Soviet Union appears less inclined to pump valuable resources into poor, strategically marginal areas. In addition, Soviet leaders are seeking to parley these changes into improved East-West relations and a role as one of two Global Security Guarantors along with the United States.

On the other hand, Western analysts have found reason for skepticism: the Soviet Union continues to subsidize Cuba (although public announcements of displeasure with the arrangement have been made). Clearly, Gorbachev must be able to clarify precisely where the Kremlin falls on the question of "no foreign interference" and "self determination." For example, does "no foreign interference" mean the opportunity for a country to choose its own government or does it mean no Western interference? This question would appear to have been answered, at least in the case of Nicaragua and Eastern Europe, but Soviet responses may be made on a case by case basis. For example, the Soviet Union sold long range bombers to Libya, internationally recognized as participating in terrorism, and continues to support other radical regimes in the Middle East.

Questions

1. What determines whether the Soviets retrench or continue involvement in a regional conflict? Is it a question of geographic priorities, military stalemate, or direct costs to Moscow?
2. Does "new thinking" as applied to regional crises and Third World confrontation signal a significant enough change in Soviet

policy that a pattern or process of cooperation for resolving outstanding conflicts may be established? Does the Afghan settlement provide a universal model for settlement of other disputes?

3. Does U.S. domestic pressure to reduce defense spending by withdrawing military and economic assets from abroad require an intensified effort to seek settlement of regional disputes with the cooperation of the U.S.S.R.?

4. Are there any prospects for Soviet cooperation to diffuse tensions in the Middle East?

HUMAN RIGHTS

The United States ties commercial relations directly to progress on human rights. The Soviet Union's domestic treatment of minorities—the nationality question and restrictions on emigration are issues of particular interest to the United States. Tolerance of Jewish, national or ethnic cultures and an acceptable emigration policy for Soviet Jewry, Armenians, and others are specific areas of U.S. interest. To the extent that policies of discrimination and rights restriction limit the human resources available for Gorbachev's ambitious programs, he may have greater interest in equality of opportunity. Elimination of the self-induced "brain waste" caused by restrictive nationality and ethnic opportunities, such as the prohibition of teaching of religion and discrimination in educational and employment opportunities, may liberate more productive reserves for what he calls the "human factor" in perestroika.

Release of refuseniks, clarification and narrowing of "knowledge of state secrets" as a basis for emigration denial, and expansion of individual rights to include practices consistent with cultural and religious traditions might increase Soviet productive reserves for energizing Gorbachev's reform program through more initiative, competition, and participation. This could entail the risk of increased emigration and "brain drain," at least initially. Such steps would likely generate a positive response from the United States.

Questions

1. Based on the U.S. policy of relating commercial benefits to human rights, does the substantial progress of the Soviet Union in these areas make issues such as tariffs, credits, and export controls negotiable?

2. Will the U.S.S.R. institutionalize human rights processes or simply allow temporary exceptions to gain a waiver of the Jackson-Vanik and other trade privileges.

3. Is progress in human rights best encouraged by reciprocal cooperation on the part of the United States and the U.S.S.R.? If so, what kind of reciprocal stage are we now in and how should progress be related to other issues, including economic relations?

COMMERCIAL RELATIONS

Throughout the postwar era, United States military and geopolitical competition with the Soviet Union has also had a strong economic component. As early as 1948, U.S. policymakers who recognized the constraints imposed by nuclear weapons, made military containment and economic embargo key elements of a long-term

strategy to limit the thrust of Soviet expansion. Therefore, a traditional goal of the United States has been to deny or delay economic benefits to Communist countries. When considering the granting of benefits, U.S. policymakers have employed leverage ("carrots" and "sticks") particularly with regard to normalizing commercial relations with the Soviet Union.

The United States has maintained its commitment to denying or delaying Soviet acquisition of advanced technologies and dual-use products. Exports of sensitive technology to the Soviet Union have been controlled through domestic export controls set forth in the Export Administration Act and through multilateral export control efforts administered in concert with NATO and Japan through COCOM (the Coordinating Committee for Multilateral Export Controls). A second focus of U.S. economic pressure has been to limit Soviet ability to import goods and engage in joint venture agreements by restricting credits. Since Soviet currency is inconvertible, without Western credits the Soviet Union may import only those goods which it can pay for from hard currency cash reserves. Third, the United States has also practiced a policy of denying trade reciprocity, thereby limiting the possibilities for Soviet enterprises to export goods to the United States (further limiting hard currency earnings) and practicing leverage by linking the future granting of Most Favored Nation (MFN) to progress in human rights and emigration performance.

Ongoing progress regarding issues of arms control, regional conflicts, and human rights has created an environment for the initiation of broad negotiations on bilateral commercial relation. Indeed, without progress across the whole spectrum of United States-Soviet issues, an expansion of commercial relations is not likely to be stable, particularly in the longrun. Since 1985, U.S. policy on commercial relations with the Soviet Union has been to encourage nonstrategic trade and to reactivate some of the mechanisms of cooperation that existed in the 1970's. Although improvement in the overall relationship has been treated as the first condition for any significant expansion of commercial relations, many specific issues have begun to be addressed. Trade facilitation measures, the establishment of joint ventures, scientific, technological and cultural exchanges have been reinitiated and expanded. Some recent examples, in addition to negotiations on a United States-Soviet trade agreement include:

The United States-U.S.S.R. Commercial Commission, headed by the Secretary of Commerce and the Soviet Minister of Foreign Trade, have met several times to discuss the problems and prospects of economic interaction. Working groups were established to encourage activity in five sectors—food processing, energy, construction equipment, medical products, and services (such as insurance).

Both the Pentagon and the Department of Commerce with joint jurisdiction on technology transfer, have accelerated the processing of applications, and the administration has announced that it is reassessing its restrictive position on export controls.

The development of commercial activities raises questions of minimizing the security risks while optimizing the economic bene-

fits of trade to find a proper balance between security, political and economic gains.

Questions

1. Should variations in arms control, regional issues, and human rights processes directly affect United States policy on commercial relations with the U.S.S.R.? How should the United States frame its commercial policy relative to the economic system and institutional flux in the U.S.S.R.?
2. Is it in the United States interest to facilitate Soviet efforts to regain economic viability? What can the United States expect in return for granting trade benefits?
3. What role should U.S. credit play?

ALLIANCE ISSUES

While there has always been a shared perception of the Soviet military threat to the Alliance, important differences have emerged, especially since the ascension of Gorbachev.

In its leadership role the United States has shown a willingness to expend more on defense and to forgo opportunities presented by commerce, to set an example for the West with regard to policies toward the Soviets. It was argued that it was in the interest of all parties to cooperate in a strategic embargo and lending limits. NATO accepted the costs of lost economic and foreign policy gains in order to restrict possible Soviet economic benefits.

The benefits of access to the U.S. market have been viewed as greater than those of the Soviet market, and the United States has been willing to be a net importer in the postwar era in order to "compensate" the Western industrialized countries for the foregone trade in traditional Eastern bloc markets. This was most evident when the United States extended Marshall plan aid and led an embargo of the Eastern bloc.

United States-Soviet relations must also be considered in a global framework of revolutionary changes currently taking place: the globalization of international markets, the information revolution, the emergence of the European Community as a unified economic and political entity, the emergence of Japan and the Asian NIC's, the tremendous changes in Eastern Europe, and the commencement of reform in the Soviet Union itself. The new dynamics hold opportunities both for the trade creating outcomes of an embrace of global institutions and trends, or for the trade limiting outcomes based on increased regionalism and protectionism.

United States policies toward the U.S.S.R. may or may not capture these dynamics and may or may not lay the groundwork for consensual Western policymaking on future economic and security matters. Certainly, the North American, West European, and Asian nations may cooperate to form the basis for an effective policy toward the Soviet Union, targeting policies to favor market-oriented, pluralistic reform and a further reduction of the Soviet military threat. Alternatively, the Western nations may see themselves as competitors for Eastern markets and may decide to compete commercially, with the potential to fall into a destructive bidding process. Future policymaking and outcomes are difficult to

predict. In an increasingly interdependent global economy, each of the Western partners perceives new opportunities and obstacles in accomplishing economic and political goals. As U.S. policymakers assess the emerging global environment and reassess the underpinnings of decisionmaking in an international context, careful consideration of the perceptions and goals of the emerging regional players—in particular North America, the EC, and Asian economic powers is important.

The United States, though it continues to be a major power in the world economy, has also begun to recognize the need to expand its exports and increase competitiveness. Spurred by a deepening trade deficit, a shift from long-time creditor to debtor status, and increasing foreign involvement in the domestic economy, calls have intensified for more aggressive trade policies and for review of export control and sanctions policies that may inhibit U.S. competitiveness. In the context of a changing position in the global economy, opportunities for trade with the former "Eastern bloc" may be viewed by the United States with greater interest, particularly since our major competitors—Japan, West Germany, and other West European countries—are responding positively to such opportunities.

The rise of the European Community as an economic power highlights the potential for growing tension between the United States and the EC. The EC nations have signaled that although they do not necessarily want to replace U.S. leadership, they are not willing to accept American unilateral decisionmaking particularly with regard to commercial issues. Disagreements have emerged regarding the future nature of West-West and East-West trade. Global oversupply in some sectors, structural unemployment, and keen competition between industrialized nations has caused friction between those seeking to rapidly enter the East European and Soviet market and those who stress continued vigilance for both economic and security risks with regard to commercial restriction toward the Soviets. In the context of escalating tensions, questions have arisen concerning what actually constitutes legitimate export controls, what are acceptable amounts and terms for lending, and what should the future configuration of NATO be?

Japan and the Asian NIC's also have emerged as global economic powers, but who will provide the outlet for that power? In Asia the Soviet Union may be able to offer to Japan and South Korea political opportunities for resolving outstanding issues and offering markets and sources of material inputs.

Questions

1. How do alliance policy options differ in the views of various Western leaders?
2. What are the lessons of past alliance disputes for the future (e.g. the pipeline dispute, the *Toshiba-Kongsberg* case)?

ARMS CONTROL

Arms control and security matters have been a key concern of the West European nations throughout the postwar era. NATO was established in the immediate postwar period and has functioned

both as a pillar of West-West relations and a countervailing to force Soviet military aggression. Now, four decades later, the Western allies agree on overall themes but appear to be far apart in their views of how to respond to the profound changes that Gorbachev's policies have set in motion both in the Soviet Union and Eastern Europe.

The NATO nations, for example, agree that the current imbalance between NATO and Warsaw Pact forces is the major factor that could destabilize East-West security relations and that the Western proposal to reduce this imbalance would create a more stable East-West military relationship. The allies agree that any accord would have to be accompanied by intensive monitoring and cooperative measures to enhance stability and ensure verification measures. Most allied governments agree that they must maintain a viable nuclear deterrent and ensure a U.S. commitment to European security, but the West European governments would like to see further reductions in the number of nuclear weapons deployed in Europe. It is precisely the issues surrounding reduction of nuclear weapons that have produced deep divisions among the allies, within allied governments, and in their political systems. The French fear a denuclearization drive by Gorbachev, the British have favored modernization, and the West German Government is under pressure not to modernize short-range nuclear weapons, but rather to pursue arms control reductions. At the same time, some in NATO fear that arms reductions could sever the American commitment to Europe.

Questions

1. Is Soviet policy directed toward splitting the United States from Europe?
2. What may NATO do to ensure American involvement in European security, e.g. provide a place for the United States in the Common European House?

REGIONAL ISSUES

As the West European countries moved from global to regional powers, regional issues outside Europe have receded in importance to them. For example, when the U.S.S.R. invaded Afghanistan in 1979, the West European allies protested the action by imposing comparatively lighter and much shorter sanctions than did the United States.

The Asian economic powers have a keen interest in regional issues—Japan in the Kurile Islands and South Korea with regard to North Korea. In Japan's case, resolution of the disputed Kurile Islands must be seen as a precursor to significant progress in bilateral political and economic Soviet-Japanese relations. In the event that a resolution is reached, however, the prospects for Japanese capital investment and the expansion of Soviet-Japanese trade seem likely.

Questions

1. What are the implications for Soviet-Japanese relations if a political compromise is reached on the Kurile Islands? What would

United States reaction be to substantially closer Japanese-Soviet relations?

2. Considering the Toshiba-Kongsberg incident, what are the risks of increased Soviet-Japanese economic cooperation?

HUMAN RIGHTS

The Conference on Security and Cooperation in Europe (CSCE) was established in Helsinki in 1975 as a forum for dealing with European security issues and politico-military confidence building measures in Basket I; economic, science and technology, and environmental cooperation in Basket II; and cultural, educational, and humanitarian cooperation in Basket III. From the point of its establishment, the West European nations took a broad view of the purpose of CSCE, hoping to use it as a framework for expanding detente and East-West trade, reducing and eventually eliminating the division between East and West Europe.

Starting in early 1987, CSCE participants focused on establishing another round of conferences on conventional weapons reductions, confidencebuilding measures, human rights. For Western participants as a group, compliance issues and human rights, including freer flow of people, information and ideas, have been issues of concern. Nevertheless, the West European nations distinguish themselves from the United States in that the United States focuses on specific human rights cases and to a much greater degree seeks to ensure that human rights is accorded as much attention on the CSCE agenda as are issues of arms control and trade cooperation. Human rights has in general not been a focus of Japan.

Questions

1. What are the conditions of the West for Soviet sponsorship of the 1991 CSCE meeting in Moscow?

2. How serious is the Soviet Union's commitment to become a civil society with rule of law, protection of minority rights, and religious freedom?

COMMERCIAL RELATIONS

Traditionally, the West European governments have used trade as a tool of statecraft to achieve both economic goals and broader foreign policy goals. Economics have been part of a broader strategy of detente, "Ostpolitik." Now the West European nations appear to be viewing increased economic relations with Eastern Europe as a potential for opening new markets in a global economy fraught with problems of oversupply, increased protectionism, and market restrictions. Second, the West European nations view developments in the former Eastern bloc as an opportunity for new relations between individual countries and between the EC and the "bloc" countries. Clearly, both economic gain and elements of the "Common European House" have played a role in the emerging new relationships.

Insofar as U.S. and allied policy has diverged in the past, issues of tension have arisen with regard to credit and export controls and could continue to do so in the absence of policy coordination. In addition, activity in free economic zones may also come under

scrutiny. These tensions have been exacerbated by the decreasing perception of Soviet threat at the same time as the increasing preoccupation on the part of the West Europeans regarding internal market changes. Similarly, the Japanese and the NIC's see opportunities for opening markets in Eastern Europe and the Soviet Union.

Credit Controls.—The use of finance to achieve trade promotion demands that exporting governments undertake much of the risk of lending. Normally, if states decide to assume financial risk, they do so in order to stimulate exports. When states assume all or some of the financial risk of lending they reduce the cost to exporters of financing trade and thus make their exports attractive to potential importers. The cost of borrowing will be reduced because when governments assume risk, interest rates, which reflect risk calculations, are below what the borrower would have to pay under normal market conditions. There are two ways in which governments (i.e. taxpayers) can assume that risk, be it for political or purely economic objectives: they can grant direct credits or they can provide export credit guarantees and insurance policies. This serves the broader commercial interest of the lender. But also, by assuming some of the risk, governments use trade as a foreign policy instrument by providing incentives for less creditworthy borrowers to buy from them.

Regulation of financial flows to the Soviet Union and Eastern Europe has been a key element of Western control of nonstrategic trade. In order for the CMEA countries to import goods from the West, they have been required to have either sufficient hard currency earnings, reserves or access to Western financing. Because their currencies have not been convertible they have had to pay for Western goods with hard currency cash. Since their goods have generally not been of high enough quality to export, and earn hard currency, credit has been important. The development of Soviet-Western joint ventures exerts increasing pressure on hard currency supplies and ultimately on the demand for Western credits.

By the end of 1988, new credit facilities for the Soviets offered by Japanese and West European creditors had provided about $8 billion. In an effort to expand its access to capital beyond direct loans, the U.S.S.R., through its Bank for Foreign Economic Relations, launched its first bond issue in 1988 for 100 million Swiss Francs ($74 million). A second bond issue was offered in July 1988 through a consortium of West German banks for approximately $271 million. This activity in the foreign bond market could subject the U.S.S.R. to disclosure requirements on the extent of its debt, currency reserves and balance of payments which has not been made public before.

The prospect of increasing Soviet activity in Western capital markets has raised concerns that "uncontrolled" or "preferential" funds made available to the U.S.S.R. could be channeled to other purposes that may be adverse to U.S. and Western national security interests. There is also concern about both political and business risk in prospective Soviet development.

American critics charge that the consensus agreement is both incomplete and invalid. Reflecting this concern, Senator Bradley had called for a coordinated Western policy to eliminate subsidies on

lending to the Soviet Union on the following basis: first that "loans, credits, guarantees or insurance, or other subsidies that artificially reduce the risk of doing business in the Soviet Union and the cost of Soviet borrowing; that it allows the Soviet Union to escape the hard choices between guns and butter; cheap credits could lead to excessive Soviet borrowing and a potential debt crisis; The Soviet Union then competes with the Third World for limited capital funds."

On the other hand, proponents have argued that, over the past 5 years the consensus agreement on lending has rarely been violated and it has prevented subsidization by Western governments of Soviet credits. For example, Dan Bond writes that, "Until 1983, interest rates on officially supported export credits were clearly well below commercial loan rates, by as much as 10 percentage points. But afterward, as the minimum consensus rate was pushed up by agreement and commercial rates dropped, the relationship was reversed. This indicates that the potential for direct interest rate subsidies to the Soviet Union from official loans have largely been eliminated. This will likely continue to be the case in the future since the minimum consensus rate is now based on market interest rates." Evidence shows that "the cost of Eximbank loans to the Soviet Union—if they had been made during this period would have been sharply reduced starting in the early 1980's, and eliminated by 1983.

Apparently, while West European governments have been willing to adhere to the consensus agreement, they have opposed any attempt by the United States to move outside of the agreement toward selective denial of Soviet credits. This was a subject of alliance tension with the trans-Siberian pipeline in 1982. In each case, the European allies held the United States government to its commitment to the consensus agreement. Indeed, the West European nations are more than likely to continue to insist on the continuance of the past framework, particularly in view of the evidence that the U.S.S.R. and East European countries had not succeeded in borrowing below competitive market lending rates.

Questions

1. Is Soviet borrowing significant? Are they creditworthy?
2. Does Soviet borrowing threaten Western military security?

Export Controls.—For the West European nations, balancing the trade-offs between national security and economic gain has been a subject of continuing interest in East-West commercial relations. The NATO countries and Japan have participated in COCOM to coordinate the control of strategic goods to Communist countries throughout the postwar era. Essentially, COCOM is a nonbinding "gentleman's agreement" whereby nations agree to limit the export of goods placed on the "Commodity Control List," which is agreed to by consensus of all nations involved.

While all participants agree in principle that national security controls are needed, at times divisive disagreements between the allies and the United States have developed on specific policies. In general, West European participants and Japan prefer less extensive national security controls and oppose the use of export controls for foreign policy purposes. The extraterritorial application of

U.S. export controls (the extension of U.S. controls to foreign subsidiaries of U.S. firms and foreign firms that use U.S. technology) has also been a bitter issue between the United States and the allies. Increasingly, West Europeans are willing to oppose or circumvent U.S. policy regarding East-West trade in cases where the West European countries believe that the United States has overstepped its prerogatives. The Bush administration has indicated a willingness to reassess its restrictive position on export controls.

A general atmosphere of mistrust has developed between the West European nations and the United States with regard to East-West trade. Conflicting trends and perceptions have exacerbated the situation further. On the one hand, the United States in the 1980's moved aggressively to broaden and strengthen COCOM in response to what policymakers perceived as lax West European standards—in particular to Eastern Europe. U.S. attempts to revitalize COCOM were perceived as U.S. attempts to dictate European policy from the United States and to manipulate the process in favor of American business.

West European leaders have, for example, pointed out that before the application of the "no exceptions" rule (a rule which has been suspended), American firms accounted for more than 50 percent of the exceptions to COCOM rules—a contradiction to U.S. claims that it was only European firms that had lax attitudes toward export controls. In part, these criticisms stem from contradictions in U.S. policy itself, as the military attempted to expand controls, U.S. business and the Commerce Department attempted to circumvent those controls by obtaining exceptions. A second example often cited is the United States' very liberal position toward China, where American businessmen have significant export interests versus a conservative U.S. policy toward exports to the "Eastern bloc," where European rather than American businessmen have strong export interests. Certainly, the second point may have the potential to exacerbate alliance tensions as opportunities for East-West trade open up—particularly if global growth stagnates.

Questions

1. What are the implications of Europe 1992 for COCOM?
2. How may definitions of strategic exports and dual-use technology be redefined?

Joint Ventures and Special Economic Zones.—Free economic zones are areas established by sovereign nations to allow for rapid expansion of trade by removing domestic barriers to trade, essentially creating a duty-free environment in which foreign firms may operate. Soviet leaders have announced plans to establish free economic zones, citing the Baltic states and the Far East as possibilities. While the issue has received very little attention, U.S. policymakers may wish to consider the implications of close economic cooperation between the Asian economic powers and the Soviet Union in this particular context. Certainly, in the wake of rising trade tensions between the United States and Japan, the prospects for free economic zones to develop into another "pipeline" issue should be considered. The registration of joint ventures has been expanding rapidly, but the actual number in operation is very

small—perhaps only a few hundred. Problems of repatriation of profits and ensuring adequate supplies are obstacles.

Questions

1. How does the alliance approach to arms control, regional issues, and human rights affect commercial issues?
2. Should new structures be created to coordinate Western policy regarding the integration of the U.S.S.R. into the world economy?

UNITED STATES-SOVIET COMMERCIAL ISSUES

On October 18, 1972, the United States and the Soviet Union signed a bilateral trade and lend-lease settlement agreement. In turn, certain clauses in each of the documents were contingent on the reciprocal granting of most-favored-nation status. Between the signing and ratification of the trade agreement, however, Congressional focus moved to Soviet human rights violations and national security concerns. Restrictive legislation was passed to ensure freedom of emigration and to limit Soviet access to Western credits. Soon after the provisions were signed into law, the Soviet Union rejected them as de facto interference in internal Soviet affairs and Secretary of State Kissinger declared the 1972 commercial agreement null and void. In 1979, although the level of Jewish emigration from the Soviet Union surpassed levels suggested to make the U.S.S.R. eligible for United States most-favored-nation status, overall superpower relations soured in the wake of the Soviet invasion of Afghanistan. Between 1979 and 1986 Jewish emigration from the Soviet Union remained minimal, United States-Soviet bilateral trade dropped by 50 percent and prospects for normalization of commercial relations were bleak. Since that time, emigration has increased with a record number of emigrants leaving the U.S.S.R. in 1989.

The context in which the questions of 1972–74 were asked—what are the security, political, and economic tradeoffs to normalizing United States-Soviet commercial relations—has changed dramatically both for the United States allies and for the United States itself. Although the United States and the U.S.S.R. have never been major trading partners, current developments in the economy of each country and in the international environment may be expanding the potential for bilateral commercial exchange. Most dramatic among these developments are a new look in Soviet foreign policy and Gorbachev's domestic reforms. Reflecting concern that a growing economic gap between the U.S.S.R. and the West will leave the Soviet Union a second-rate power in the 21st century, perestroika is aimed at raising the level of efficiency and modernization in the Soviet economy to one competitive with the Western industrialized nations and the NIC's. At the same time, the United States may be more concerned with promoting exports to new markets and maintaining a high degree of competitiveness to bring down the trade deficit. Similarly, the European Community is moving to develop a unified market and has indicated interest in pursuing pan- European cooperation—particularly with regard to commercial relations, as is evident in EC–CMEA agreements. Japan and the Asian NIC's will be interested in investing capital

abroad and expanding exports to new, open markets. The "Brady Plan" may be able to marshal resources for Eastern Europe. These changes have set in motion the current reassessment of fundamental assumptions, issues, and policy response to the Soviet Union in the 1990's.

IMPORT RESTRICTION

In general, the United States has supported a liberal global trading system, advocating the extension of most-favored-nation status to curb restrictive trade policies. Therefore, the United States extends reciprocal MFN treatment to its trading partners as specified in the GATT conditions for membership. MFN status implies that any trade concessions or privileges which one country grants to another country—mostly in exchange for similar privileges granted—are extended to all countries with which a country is trading. The end goal of MFN reciprocity is to foster favorable commercial terms and thereby promote the expansion of global trade.

The United States is the only Western country that denies MFN status to a group of countries based on the adoption of a particular politico-economic form of government, or economic system—centrally planned, Communist countries. In the context of improved East-West relations, several attempts have been made to restore MFN status to all or at least to selected Communist countries. To date, two attempts have been made to grant MFN status to the U.S.S.R. (1972–74 and 1979) and both have failed. Currently, Soviet exports to the United States are constrained by the absence of U.S. tariff privileges (MFN status) as well as by specific import restrictions (as well as a Soviet lack of competitive products). The Jackson-Vanik amendment to the Trade Act of 1974 makes the granting of MFN status to Communist countries contingent upon the emigration policies of these nations. As the levels of Soviet emigration have risen since 1986 and stable progress has been made in human rights and emigration, renewed discussion of what conditions would justify a waiver of Jackson-Vanik has begun. While certain modification to Jackson-Vanik may be considered, an effort to repeal the provision altogether could be viewed as a renunciation of the U.S. commitment to human rights. Some argue that the criteria of Jackson-Vanik (emigration) is too narrow, and that compliance with the Helsinki Final Act should be the U.S. standard for granting MFN. Others argue that emigration is not the proper criterion for trade privileges, and that a mere waiver (requiring recertification after a few years) is not adequate to attract business which must make a multiyear commitment. Other legislation provides restrictions on United States-Soviet trade by tightening the limits on imports of goods produced by "forced labor." The legislation seeks to enforce the provisions of the 1930 Smoot-Hawley Tariff Act, halting millions of dollars' worth of imports from the U.S.S.R. that are considered to have been made with "forced" or "convict" labor, including petroleum products, gold ore, agricultural machinery, tractor generators, and tea. Several studies have been made by the United States intelligence community to assess the use of forced labor in the U.S.S.R. but they concluded that there is insufficient evidence

to determine precisely which Soviet exports may have been made by forced labor.

Questions have also been raised over how to apply U.S. antidumping and countervailing duty law to imports from nonmarket economy countries given the difficulty in determining unfair pricing or the presence of "subsidies" in the production of goods from these countries. Legislative efforts have been made to amend the U.S. antidumping provision for nonmarket economy countries to make decisions more predictable and efficient than under the current "surrogate producer" method.

Questions

1. Should the United States maintain the Jackson-Vanik framework? If not, should U.S. policymakers seek to expand or limit trade?

2. What would be the impact on United States-Soviet trade if United States import restrictions were lifted by either waiver or repeal?

CREDITS

In general, the United States provides official export credits primarily to allow U.S. exporters to compete with officially financed exports from other countries. Guarantees and insurance are provided where similar coverage cannot be obtained in the private market at a reasonable cost.

The United States is practically the only country which denies export credit to nonmarket-economy countries on other than financial grounds. The restriction on credits applies to the spot financing programs of the Export-Import Bank (and the privately run Foreign Credit Insurance Association—FCIA—programs which Eximbank guarantees), the Small Business Administration, and the Commodity Credit Corporation. Insurance for direct foreign investment provided by the Overseas Private Investment Corporation (OPIC) is also prohibited for the U.S.S.R.

The extension of government credit to the U.S.S.R. is currently limited by provisions of the Trade Act of 1974 (Public Law 93-618) and the Export-Import Bank Act (Public Law 93-646). In late 1974, Senator Stevenson amended the Eximbank bill by placing a limit on credits to Moscow at $300 million; a second limit (the Church amendment) established a ceiling of $40 million for projects involving oil and gas exploration, and allowed no credits for actual energy production. Should the Soviets request above-ceiling credits, they could be granted only by a Presidential statement of national interest, subject to congressional approval. At present, the Soviets could get up to the limit of $300 million in U.S. Government credits only if the other impediments were removed; namely a waiver of the Jackson-Vanik and Byrd amendments to the Trade Act. The Byrd amendment (sec. 613) of the Trade Act states that no U.S. agency, except the Commodity Credit Corporation, shall approve any loans, guarantees, insurance or any combination thereof over $300 million without prior congressional approval.

While U.S. policy states that unsubsidized credits extended to the U.S.S.R. is acceptable, confusion has surfaced with regard to the

extent and type (tied or not) of lending taking place. The Reagan administration sought to clarify its policy on Western lending to Communist countries. A November 1988 interagency report determined that Soviet bloc debt to Western banks and other lenders, when adjusted for effects of changes in exchange rates, increased by only 14 percent of $13 billion between 1981 and 1986. At the same time, net debt (gross debt less deposits), adjusted for exchange rate changes had actually fallen. Second, the report concluded that lines of credit made available by Western governments, tied to Soviet purchases of Western light industrial equipment and consumer goods were judged to be (1) within the guidelines which the allies agreed to at economic summits in Versailles and Toronto; and (2) relatively small amounts of borrowing without appearance of any discernible effect on Soviet military preparedness or on the security of the West.

Senators Garn and Proxmire had proposed legislation, the Financial Export Control Act (S. 786) to permit the President to control private commercial credits to countries which are subject of national security controls. In a statement on the legislation, Senator Garn maintained that "the Soviet ability to obtain the sensitive goods and technology from the West that are turned against us in Soviet weapon systems is directly related to the ability to obtain hard currency, Western currencies."

Proponents of financing point out that the consensus agreement on lending to Communist countries has worked, and that subsidization has not occurred. Moreover, some point out that continued Soviet activity in bond markets will eventually result in the publication of Soviet statistical data previously not published in the West. Those who apparently follow this line of reasoning have suggested a new course for U.S. policy toward Western lending to Communist countries. Specifically, Representatives Garcia and Schumer introduced a bill in the 100th Congress which would require an annual report to Congress from the U.S. Department of Treasury regarding the scope of all Western and Japanese dealings with the Soviet Union. In addition, the Secretary of the Treasury would be required to enter into negotiations with members of the OECD to establish, if necessary, guidelines both for lending to the U.S.S.R. and for reporting it to allow coordination in the West.

Questions

1. How does the domestic Soviet monetary overhang effect Soviet need for credit? Is the success of perestroika tied to credits from the West?
2. If the U.S.S.R. had access to U.S. credits how much would it cost the taxpayer? Could the Soviets use credits for purposes that would adversely affect Western security?

EXPORT CONTROLS

Export control policy has received particular attention during the 1980's as efforts were made to strengthen the multilateral enforcement of national security controls among the members of the Coordinating Committee on Multilateral Export Control (COCOM). While in the early 1980's these efforts were directed to broadening

the list of controls and bolstering administrative capability, many now argue that streamlining and focusing the system is necessary to restore a balance between economic and security objectives.

Development of a Western control policy that is fully multilateral and narrowly targeted to militarily critical goods and technologies is viewed by some as necessary to compete in West-West trade. More limited use of sanctions and controls for foreign policy purposes is also considered by many to be an important condition for creating a stable and predictable contractual environment for United States-Soviet joint ventures and long-term production agreements, if these are to be pursued. The Export Administration Act Amendments of 1985, which govern export control policy, reflect these objectives. This Act is due for reauthorization in 1990.

Stable and focused export controls are essential for sound long-term agreements in production of manufactured goods. Without such stability the Soviets may prefer to look to our European and Japanese allies as trading partners. For Western control policy relating to goods, technology, and information to be effective, it must be both multilateral and narrowly targeted as concluded by both the study of the National Academy of Sciences on export controls and the Reagan administration's policy on competitiveness. Efforts to curb nonstrategic technology transfer would probably be resisted by our allies, whose cooperation is required for a workable control system.

Questions

1. Will review of the definition of strategic goods and dual-use technology be redefined in the process of reauthorizing the Export Administration Act.

2. Is COCOM outdated or will it be overtaken by events such as EC92 and the emergence of NIC's as key sources of technology? What are the options for reform, strengthening, restructuring of COCOM?

JOINT VENTURES

The link between Gorbachev's globalism and interdependence on the one hand and the transfer of technology through joint ventures with Western countries follows logically. Joint ventures that bring Western management and technology to the key Soviet economic sectors, linking global science both to applied technology in Soviet enterprises so that the quality of goods and services moves toward the world market standard and to solving global issues such as environmental concerns, could constitute a positive sum game for all participants. Ultimately, the U.S.S.R. appears to favor joint ventures with the West which are most likely to increase Soviet exports of manufactured goods to earn hard currency. The alternative of continued reliance on energy sales as the primary source of foreign exchange earnings subjects the Soviet Union to the variable world commodity markets.

Obstacles to further development of joint ventures stem, on the Soviet side, from issues of valuation of foreign imports, taxation, quality control and assured supply of goods and labor are all issues presumably to be resolved for the final agreements. On the U.S.

side, obstacles stem from political reservations to further expand bilateral commercial relations, problems of currency convertibility and investment insurance, among other things. In the absence of an umbrella framework, U.S. businessmen face increased risks in United States-Soviet business, both in comparison to other nations and between large and small firms. In addition, restrictive import and export legislation promulgated in the 1970's further retards the development of joint venture trade. Typically only those firms with sufficient resources to make a long-term investment have succeeded in establishing joint ventures with the Soviet Union.

Questions

1. What problems do U.S.-Western joint venture partners have in assuring profitable operations that the Soviet side could change?
2. What is the major gain to Soviet participants in joint ventures?

INTEGRATION OF SOVIET ECONOMY INTO THE WORLD GLOBAL ECONOMY

A major element of Soviet reform is interdependence, whereby the Soviet Union seeks to become an active and equal member of the global marketplace. Soviet leaders have made it clear that the U.S.S.R. plans to accept and operate on global standards and rules, but admits that the implementation of such standards may take some time. If Western policymakers are to judge by East European and now even the Chinese experience in transformation from a centrally planned to a market-oriented socialist model which adheres to the standards of the global marketplace, then the Soviet timetable for reform is optimistic. In the meantime, the Soviet leaders are pressing Western government and business leaders to consider its membership in international economic organizations and full integration into the global economy. Given the size of the Soviet Union as an economy and as a global military leader, the impact of the Soviet Union in global economic organizations and global markets—whether positive or negative—will be substantial in the following:

GATT.—The organization is already under strain considering the keen export competition between the Western industrialized nations, particularly in the wake of global oversupply in some sectors. Soviet participation could further disrupt the already fragile Uruguay Round agreement which participating nations are trying to develop at this time.

IMFRBRD (World Bank).—Rules must be formulated to prevent the U.S.S.R. from manipulating institutions for its own gain—particularly with regard to Third World debt, where it has much to gain by forgiving nonperforming loans, and where the West—particularly the United States—has much to lose.

Questions

1. What are the costs and benefits of Soviet accession to the foundation organization, the GATT, to the United States and other Western members, and to the U.S.S.R.?
2. What might be the steps of accession and the criteria for proceeding from informal consultative to full membership?

3. Is any Soviet membership, under any conditions, adverse to our interests?

ALTERNATIVE OUTCOMES

The formulation of U.S. policies on export controls, import restriction and credit controls will play an important role in determining whether East-West trade expands modestly, proceeds to full normalization, or is reduced to a lower level of interaction than presently exists. United States debate is likely to revolve around differing views of the benefits and costs of trading with the U.S.S.R. Policymakers are likely to be concerned with defining a constructive balance between commercial, human rights, foreign policy, and security interests.

With the exception of the grain trade, United States-Soviet commercial relations have been minuscule due to restrictive policy on both sides. The U.S.S.R. appears to be attempting to facilitate commerce through new trade legislation, by a number of joint ventures and development of a Soviet Trade Consortium that has reached agreements in principle with an American Trade Consortium for substantially facilitating commerce. In legislative policy and implementation of commercial policy the U.S. has not yet changed significantly from its long-term policy of restriction of commerce.

Given assessments on bilateral and alliance policy, with due consideration to current and past legislation and policies on imports, credits, exports, and joint ventures, views may range from restriction to facilitation of United States commerce toward the U.S.S.R. The following schematic congressional agenda of commercial issues may relate to various options, or some combination thereof which might be exercised by U.S. decisionmakers.

Questions

1. What is the basis for support of perestroika that supports our interests?
2. Is it in the United States interest to facilitate the integration of the U.S.S.R. into the global economy?
3. What clear thresholds and indicators can be established for measuring Soviet changes in arms control, regional issues, et cetera?

WORKSHOP ON UNITED STATES-U.S.S.R. COMMERCIAL RELATIONS

PANEL I.—BILATERAL NEGOTIATIONS: PROGRESS AND SUSTAINABILITY

The workshop convened April 17, 1989, in room SD-419, Dirksen Senate Office Building, Dr. John P. Hardt, Associate Director of the Congressional Research Service, presiding.

Dr. HARDT. This is indeed an important time in our bilateral relations and in the relations between East and West. We have prepared an agenda which tends to follow a logic of addressing the policy issues of United States-U.S.S.R. commercial relations in a context that would be most useful for providing a record for the Senators, Congressmen, and staff as they deliberate on issues that are now very much on the agenda.

In this context, we have prepared our first discussion and our first panel, which will be on bilateral negotiations, the point being that for all of the history of our relations with the Soviet Union and with the countries of the East bloc, issues such as arms control, regional issues, human rights, have tended to dominate, or at least provide the overarching environment within which our relations are pursued. Therefore, one cannot reasonably deal with commercial relations in isolation from these major elements of the environment.

Likewise, we cannot make policy on commercial relations and other aspects of the bilateral relationship without effective relationships with our allies. So, the second panel addresses the question of Alliance Policy in reference to the development of East-West and United States-Soviet commercial relations.

In each of the areas, the issues are familiar issues, but each has new aspects to it. These involve, in commercial relations, past experience and problems; the issues relating specifically to imports and the legislation and policy concerned with it; and the issues related to credits, to exports, and to joint ventures.

Finally, having looked at each of these issues, we plan to end with looking at the alternative outcomes and relating them to a congressional agenda. We have suggested that the general alternatives from these discussions will develop two largely opposing, or distinctive, scenarios: one toward expansion and the other toward restriction. We will discuss commercial facilitation or restriction, viewed from different perspectives, so that we may end on an agenda for Congress that provides some basis or framework for addressing each of the individual issues in the context of the overall environment and policy.

Our first panel will be chaired by Stuart Goldman, a specialist in Soviet affairs with the Congressional Research Service.

Dr. GOLDMAN. The first panel is going to be focusing on a range of bilateral issues in United States-Soviet relations. If I can borrow an analogy that my friend, John Hardt so often uses, United States-Soviet commercial relations can be thought of the fourth car—some people call it the caboose—in a four-car train of United States-Soviet relations, in which security issues and regional issues and human rights issues come first.

In order to assess what the prospect is for commercial relations, it is first necessary for those preceding three cars to be on the tracks in order to know how far down the track and how fast commercial relations can proceed. This is why this first session is focusing on things that do not seem, on their face, to be directly related to commercial factors.

We have an excellent panel with us this morning to lead things off. Speaking in this order will be Col. Ty Cobb, Francis Miko, Mark Levin, and Herb Levine.

To lead off, then Ty Cobb is a retirec colonel, U.S. Army, faculty member, Military Academy, and served many years on the staff of the National Security Council as a Special Adviser to the President on National Security Affairs. For quite a few years he was Director of Soviet and European Affairs on the National Security Council. Ty is now working with the Center for Naval Analysis.

Dr. COBB. Mr. Chairman, early this morning, Dr. Goldman and I had the opportunity to remark on how dramatic the changes have been in the Soviet Union. Who would have thought even months ago, let alone years ago, that we would have witnessed the nationality uprisings, a modicum of free elections in the Soviet Union, the outspokenness that has characterized the Soviet press recently. And in those surprising elections, of all things, the commander-in-chief of a group of Soviet forces is defeated by a lieutenant colonel, running on a platform espousing an all-volunteer army. The head of the Northern Fleet is defeated, and, perhaps most dramatically, the head of the Leningrad Communist Party, Soloviev, running unopposed, loses, to himself. These are clearly dramatic changes, and I think they mirror many of the changes that have taken place in the bilateral relationship over the last decade.

I have been asked to address my remarks to this change in the security relationship and the foreign policy relationship, and then, at the end, to briefly relate it to what impact this may have on East-West commercial relations.

I think most people in this room can recall back to the 1970's, when General Secretary and President Brezhnev was espousing the line of "sootnosheniye sill," or the correlation of forces, had clearly shifted to the advantage of the socialist camp, headed by the Soviet Union. Indeed, given the economic situation in which the Soviet Union then found itself, the promising energy situation first and foremost, the rather stable leadership, the expansion, the military modernization and expansion program, coupled with the post-Vietnam withdrawal in the United States, the stasis that had set in in our national leadership, our economic problems, all taken together clearly indicated that there may be some truth to Brezhnev's claims.

But how far we have come. Today, clearly the correlation of forces, to use the Soviet phrase again, has shifted to the advantage of the capitalist camp, if you will, to the Western Alliance on virtually all fronts.

We witnessed in the Soviet Union, at least for the first 5 years, virtual stasis in their leadership, economic difficulties that are now referred to as the "era of stagnation," problems within the alliance system, withdrawal from the forward positions they secured in the Third World to the point where the Soviet Union, now, rather than the United States, is the world's leading counterrevolutionary power, supporting corrupt regimes, while the United States and its allies actively support what the Soviet Union formerly referred to as "National Liberation Movements."

This position, I would assert, Mr. Chairman, leaves the United States today in an excellent position. While United States-Soviet relations are clearly better than they have been in a long time, the most important point is that our position vis-a-vis the Soviet Union is better today than at any point in time I can remember since the Second World War.

Specifically, let's look at the foreign policy and arms control agenda, with special attention to the reasons why I feel we are in this advantageous position.

The past administration, in concert with its allies, approached the Soviet Union with a four-point agenda. This was not always palatable to the Soviet leadership. First and foremost among these was human rights, a subject that had not been regarded as opportune or one on which the Soviet would welcome discussion.

I think the progress there has been real, although there is a long way to go.

We also indicated we wanted to talk and establish a very active dialog on regional issues. That has been done. But, by the same token, we made it clear to the Soviets that we would pursue a program of actively supporting the anti-Communist insurgencies in the Third World. I think this contributed to the bind the Soviets found themselves in, in Afghanistan, in Kampuchea, and in Angola, and certainly even in Nicaragua.

As I said, I think this has resulted in a situation in which the Soviet Union is clearly on the defensive. But, much more importantly, Mr. Chairman, I think important voices within the Soviet leadership and in the Soviet Union have come to realize that their extension into the Third World, their aggressive policy of supporting the so-called national liberation movements, were actually counterproductive; that all they really did was worsen the relations they were trying to establish with the United States.

I think this is coming to be realized by senior officials in the Ministry of Foreign Affairs, as well as elsewhere, not just the military expansion, the power of projection, but the aid that they provided.

I was struck by a remark one Ministry of Foreign Affairs official made regarding the Soviet aid to the Third World last October. He said:

> The aid itself is only the tip of the iceberg. Our direct and indirect involvement in regional conflicts led to colossal losses by increasing general international tension, justifying the arms race and hindering mutually advantageous ties with the West.

I think this is a striking realization that was brought about by the policy that we had pursued.

There is not a lot of time to go into detail. But on the arms control agenda, I think it is also important to note here that the Western Alliance has approached this agenda item as well with a very hardnosed philosophy.

We begin with the assumption that we did not seek agreement for agreement's sake, but only would pursue agreements that truly enhanced our national security and that of our allies.

I think that we also had the courage to resist tremendous pressures that were put upon us at various times to make unilateral concessions—for example, toward a nuclear freeze or to halt the deployment of the INF missiles in 1983.

We also pushed I think equally hard—and this is very important—for agreements that did not just merely limit the expansion of the arms race, but would bring about deep reductions. The Soviets resisted this, but we have prevailed.

Third, and I think perhaps just as importantly, we have put forward the idea that deterrence should be based on something other than a simple reliance on the annihilation of each other's populations; that by integrating forms of strategic defense, we could have a more stable form of deterrence. I think the Soviets have clearly taken our intentions to pursue what is known as the SDI policy very seriously, and they certainly give us credit for having the capability, the technological and economic wherewithal, to pull that off.

I think the net results of all of that are very clear for everyone to see. There has been dramatic progress. We managed to sign an agreement whereby we established several important principles. The first is that of asymmetrical reductions, which the Soviets had resisted for years. But, in fact, the INF Treaty did provide for asymmetrical reductions, with the Soviets reducing much more than the West.

It also includes intrusive verification procedures, including onsite inspection. We were also able to ensure that the British and French forces were not included in our calculations in these figures.

I think that the results of the INF negotiation bode very well, Mr. Chairman, for future progress on the conventional arms talks now beginning in Vienna, and for the strategic arms limitation talks, although they will be very, very difficult.

The bottom line coming out of the foreign policy aspects of the relations of our Third World dealings and the arms control agenda is this: The progress that has been made over the past decade has created an environment in which one can anticipate that there should, and could, be an expansion of commercial relations.

I realize this is not the primary thrust of my talk, but I would like to draw the lesson, Mr. Chairman, that following the general policy that we pursued in economic relations with the Soviet Union over the past decade warrants serious consideration. I think that doing so would bring about the progress that we need, along the lines that we have achieved in the foreign policy and arms control arena.

Specifically, what I have in mind here is that the administration pursued a policy of economic realism—and I want to make this clear—not of economic warfare. There has been a lot of discussion in the Soviet press that the United States had a particular policy of trying to entice the Soviet Union to participate in an arms race which would bankrupt the Soviet Union. That is not true.

But we did have a policy that said we wanted to pursue normal commercial relation, that we wanted an expansion of nonstrategic trade. At the same time, we would not assist the Soviet Union, in alleviating its economic dilemma, if it chose to continue the irrational resource allocation choices that it had made. The U.S.S.R. alone must bear the burden of those choices imposed. We were not going to step in, as we did in the 1970's, to alleviate those problems.

I would assert in conclusion, Mr. chairman, that this sort of realistic policy on commercial relations, as well as on arms control and foreign policy questions, should guide us in the future.

Dr. GOLDMAN. If security and arms control issues have traditionally been the first car on the train, then the issues of regional competition and regional conflict have been the second. To address that question we have Francis Miko, a longtime colleague of mine from the Congressional Research Service, a specialist in Soviet and East European Affairs, who has written extensively on Soviet foreign policy and the interaction of foreign and domestic policy.

Mr. MIKO. I think it is particularly relevant that we do look at regional issues for a minute, as we look toward discussing United States-Soviet commercial relations.

The main reason I say that is if we look back to the past, to the 1970's, we see what a strong impact regional crises have had on our economic relations, and what strong a linkage there has been.

Our economic punitive actions against the Soviet Union in response to Afghanistan and Poland signed the final death knell of an economic relationship that had already been sharply deteriorating because of emigration and human rights issues.

Furthermore, as we look to the trend that seems to be taking place now, we can see how important the regional settlements that we have achieved, particularly the one in Afghanistan, have been to even getting us to where we may again be looking at easing of commercial relations. Certainly, it may be not quite as important, but the settlements in Kampuchea, Angola, and South Africa have also played a role in changing that atmosphere.

Finally, I would argue that regional issues are the wild card, the aspect of our relationship that we will not be able to control in the future, and that could, again, step in to disrupt the trend toward a more normal United States-Soviet relationship.

As we look at the very major shift the Soviet Union has apparently made in its policy in various Third World regions, the question arises of whether this is a fundamental and deep Soviet change of policy, or whether it is a temporary, tactical retreat. It will be some time before we know the answers to those questions.

But there certainly have been some real changes in policy, and I think with Gorbachev's new thinking and new priorities, we can see a definite shift in the role the Third World plays, as compared to East-West relations, as compared to other regions of the world.

We also concede that the balance between the more radical regimes in the Third World and the, say, more affluent and successful major Third World powers seems to be under reexamination in Soviet policy.

Finally, the Soviet Union I think is reexamining the instruments with which it does and is able to influence events in the Third World, and finds that having only military and arms supply options may be too limited.

Second, we can see a real change in the Soviet relationship with the United States and China, and the other major great powers with which they interact. This is putting Third World problems in a new light.

Finally, the Soviets face a very different situation on the ground in the Third World. I certainly think that the fact that they face a situation of virtual stalemate in many of the regional conflicts had a lot to do with their reassessment of what they are doing there.

As we move into this new period of negotiation in the Third World, the Soviets themselves are offering a formula for settlement of all Third World disputes. I think it would be worth examining as to how viable and real those are.

The Soviet Union basically takes the Afghan model and says that that could be applied anywhere, and what they see as the Afghan model is withdrawal of all outside powers, an end of all outside aid, national reconciliation among all the forces within the dispute region, great power guarantees of any settlement that comes out of it, and a more active use of the U.N. for both mediating and peacekeeping roles.

A number of cynics say that the Afghan situation was really so unique, it cannot be easily applied, and that, anyway, the Soviets may not be quite so serious about this and they may be blowing smoke in an effort to put a better face on their retreat from Afghanistan.

Furthermore, the Soviets are now emphasizing the issue of codes of conduct between the superpowers and the Third World. Here we have a flipflop of the attitudes and roles of the superpowers because, as you recall in the early 1970's, there was a very strong interest in this country in establishing some kind of code of conduct for our policies and the Soviet policies in the Third World.

Well, now the Soviets are talking about that much more. But, given our experiences of the early 1970's, there seems to be very little enthusiasm that I can detect right now, on this side, in the administration, and even outside, on establishing sort of broad, general codes of conduct.

Nevertheless, the Soviet policies—the changes—do raise a serious question for us, and that is are we prepared, if the Soviet Union is engaged in new, more constructive policies, to deal them in in Third World crises, where they have not been involved to date.

I think these policies may be tested in future regional problems. There are three that I think are very current, where we may see pressures very soon.

First, of course, is Central America, which is the one named Reagan doctrine region that had not yet received much attention in the United States-Soviet dialog. Now President Bush has indicat-

ed that Soviet behavior in Nicaragua, in the region, would be a litmus test of their good faith toward us.

Gorbachev's trip to Cuba is somewhat inconclusive. From what we read and see, apparently it was not a tremendous success. It remains to be seen whether Gorbachev follows this up with some cutback of his massive assistance to Cuba and to the region.

Clearly, if he is looking for costsavings on Third World expenses, that would be a key area.

The second region of concern is the Middle East. There the Soviets have acted very forcefully to insert themselves as a more serious player in the Arab-Israeli dispute. There is their new policy toward Israel, which seems to be moving toward reestablishment of normal relations, and improvements in emigration policy, which is tied to that, and also their apparent pressure on the PLO to take a somewhat more flexible position.

Also, I think, as we look at the Soviet policy, you can see that they may have a greater interest now in peaceful settlements because the proliferation of arms in the Middle East region is at least as threatening to the Soviet Union over the long run as it is to us.

It is a key question for U.S. policy whether we are prepared, or whether it is in our interest, to deal with them in that situation.

Finally, I would say the most immediate and, potentially for Gorbachev, most explosive regional issue could be Eastern Europe. Given the very rapid changes taking place there, the uncertainty and still ill-defined Soviet policy and limits of tolerance in that region, a lot can happen.

As you know, within the administration and in the country as a whole, I see an unprecedented debate over what our policy toward Eastern Europe should be. I think I would predict this would be the first test of the new regional cooperation. The question again concerns two of the main lines of the debate: should we be talking to the Soviet Union about establishing a new order in Eastern Europe, or should we let their developments take their natural question course.

Dr. GOLDMAN. The third car in this train is that of human rights. That is the one which has been most strongly and most permanently coupled to the commercial relations car.

To talk with us this morning about the human rights issues is Mark Levin, from the National Conference on Soviet Jewry. Mark has been here in Washington representing the National Conference for the entire decade. Since 1987, he has been the director of the Washington office. He is an experienced player here on the Hill, and we are very fortunate to have him here to address this issue.

Mr. LEVIN. What I thought I would do is spend the next couple of minutes talking to you about the changes that have taken place over there last year, and then go into our review and assessment of where we think specifically the Soviet Jewry movement is going, and then, obviously, what some of the larger questions and their implications will have on our movement.

First, let me echo some of the opening comments made by Dr. Cobb. Particularly in the human rights area we have seen some remarkable changes, not only in the atmosphere, but on the ground, inside the Soviet Union, affecting not only Soviet Jews but other groups as well.

We are in a very fluid situation today, as opposed to what we experienced through much of the decade of the 1980's, where what the National Conference and other human rights groups were really trying to do was to keep the issue alive.

It has only been in the last couple of years where we could talk about human rights issues as being a part of the legitimate four-part agenda. I think you can trace the turning point to right before the 1984 election, when Mr. Gromyko came to visit the United States and paid a courtesy visit to the Democratic candidate, Walter Mondale, but spent quite a bit of time talking to the incumbent, Ronald Reagan, and other members of his administration.

I think, if anything, Gromyko's trip was a signal that they were ready to move forward in the relationship and to try to restart the dialog that had existed through most of the 1970's.

We can almost see what happened after that meeting in terms of the first summit meetings and an elevation on many different levels in the bilateral dialog.

Human rights is one of the four main agenda items between the United States and the Soviet Union. It is probably, next to the arms control issues, the most visible, and the one that has elicited some of the strongest reactions, not only from Mr. Gorbachev, but from many of his predecessors.

What we have been able to do is to make human rights a very legitimate part of this relationship, and to see that it is interconnected with many other issues.

One issue, however, that we tried not to link this to has been the arms issues. We have purposely stayed away from those because we did not want to be accused at some point of preventing the two superpowers from getting together and lessening nuclear tension.

Now, I did just mention some improvements. From our point of view, they have been very positive, not only in terms of emigration, where the numbers have increased from less than 1,000 in 1986 to almost 19,000 in 1988, and for 1989, we are looking possibly at anywhere between 25,000 and 50,000 Soviet Jews getting out, and an equally large number of Armenians and Germans. These have been the three groups that have traditionally been able to emigrate from the Soviet Union in sizable numbers.

But what we are seeing—and it is really something quite different—is an increase in the numbers of Pentecostalists, Baptists, and others, who are slowly beginning to apply to leave. In fact, when compared to the figures of just a few years ago, they are getting substantially larger numbers of permissions.

What is interesting to note is that many of the Pentecostalists and Baptists who are getting out are actually getting out on Israeli visas. The Soviets still do not feel comfortable in letting most of these individuals out on other types of visas.

We also have seen something happen in the last year that we have not seen for the last 15 years. The National Conference has a twin focus. Most of you know that we spend a great deal of our time advocating the right of Soviet Jews to leave the U.S.S.R. But we have another focus, and that is to try to improve life inside the Soviet Union. While that has not received a lot of attention over the past few years, it has mainly been because of the lack of potential in this area. That has really changed in the last year.

Soviet Jews do not feel the pressure that they once did from the government not to congregate. There are, literally, dozens and dozens of study groups, cultural centers, and even publications, unofficial publications, taking place now.

This is a very remarkable change, and I think this is true for many different groups, not only Soviet Jews. Obviously, it can be traced to Mr. Gorbachev's push for "glasnost" and "perestroika." They have almost become twin cliches. But there have been some positive developments out of this push to put a new face on life inside the Soviet Union.

What we have tried to do this year is really focus on a few basic issues, and to try to get this current administration to look at these issues, and, when the opportunity presents itself, as it already has with the recent meeting between Secretary of State Baker and Foreign Minister Shevardnadze, we will hopefully see a continuation of the improvement, which could then lead to the National Conference taking a different position in regard to certain specific areas of the commercial relationship between the United States and Soviet Union.

Very briefly, we continue to advocate for the emigration of all refuseniks, with a priority given to those remaining, what we term, 2,600 long-term refuseniks. Many of these people have been waiting up to 17 years to leave.

At the same time, we are looking for an emigration process that is systematic, substantial, and sustained, something that, while not timed specifically to a level of emigration, that would allow an individual to know what his chances are of being able to emigrate, with a particular emphasis on an establishment of a reasonable time limit in the area of state security denial.

Now, in the other main area, the cultural and religious freedom area, we are making a big push for the recognition of Hebrew as a legitimate language of the Jewish minority in the U.S.S.R., the registration of Hebrew teachers and study groups and access to Hebrew language materials. This is something that is slowly taking place, but still has not occurred.

Really, what we are trying to do is to allow these people to function out in the open, as opposed to behind closed doors.

We also would like to see a broadening, or a continuing of the broadening of freedom of Jewish religious and cultural practices, as well as the opportunity for Soviet Jews to form associations with Jews in the U.S.S.R. and other countries.

Finally, we would like to see the elimination of all forms of official and public anti-Semitism. What is most distressing to us in this era of "glasnost" is the rise of popular anti-Semitism. It is very distressing. It is not just one group that most of us have heard of, "Panyat," but it has spread, really, throughout the general population.

It has caused a great deal of fear among the activists and refuseniks in the Soviet Union.

Now, the one area that is most related to this forum is trade. In recognition of what has happened over the last 15 months, in January, the National Conference announced that it would review and assess its positions on United States-Soviet trade policy, more specifically, the Jackson-Vanik amendment.

What we have tried to do in this area is two things. One is to let the Soviets know that we recognize that positive changes have taken place. Second is what specific areas are we looking for to change our current position.

What we have done is organize a trade working group that has been meeting periodically. This group will bring its recommendation to our next board meeting in June. We hope to bring our view to closure in June. We are considering four main areas. These are the rate of Jewish emigration; the release of the refuseniks, particularly the long-term cases; what the new law that the Soviets have promised in the area of emigration will look like; and the fulfillment of Gorbachev's promise to apply the state secrecy ban to emigration "with strictly warranted time limitations." Based on these four conditions, we will come out with a public statement in June.

Dr. GOLDMAN. At this point, we need to depart from the four-car train analogy because the next item on this miniagenda has to do with the developments of Soviet economic and political reform.

Strictly speaking, "perestroika," Soviet domestic reform, is not a proper issue in bilateral United States-Soviet relations. But, in fact, the way we, in the West, evaluate the progress in reform and the sustainability of those reforms, plays a very important part in our net assessment of the way we ought to go ahead and the extent to which we ought to go ahead with commercial relations.

We are fortunate in having with us this morning to speak to this question Prof. Herb Levine of the University of Pennsylvania. Professor Levine is a professor of economics and a codirector of the Lauder Institute for Management and International Studies. He is also a member of the board of the National Council for Soviet and East European Research. Professor Levine has written extensively on Soviet economic reforms and economic developments.

Dr. LEVINE. What I would like to do in trying to give a background and assessment of where Soviet economic reform is today, is to focus on the issue which I think is the critical issue, and that is the transition process.

Rather than putting a lot of effort and a lot of time into discussing whether they have the right model for where they want to go, my feeling is that they have enough in that model that at least things can get started.

But the problem is how do you get from here to there. That is what I would like to spend some time on.

Essentially, the objective of Gorbachev's radical economic reform is to decentralize decisionmaking. But an economic system is an interrelated set of activities, and to decentralize decisionmaking in the Soviet economy requires that Soviet managers be given a number of discretionary decisionmaking rights.

They have to have rights over the materials that they are going to employ, which means that the whole centralized supply system really has to be removed, and something on the order of a wholesale trade system put in its place.

Second, managers have to have control over the labor inputs, which means that they have to have increased rights to change the labor force—not only to dismiss workers who are not working well, but to dismiss workers who, because of technological change, are

now redundant. This is a major change in Soviet labor relations and, indeed, social relations.

Third, managers have to have rights over capital stock. This means they have to have significantly increased ability to buy the machinery that they feel is needed. In order to do that, they have to have the ability to acquire investment funds, not only investment funds from state banks, who perhaps are locked into state interests, but access to investment funds that are independent of any sort of overall government plan, and an investment sector that will be making judgments upon the creditworthiness of the types of projects that are being put before it.

If these rights are to be extended, there have to be some constraints. These constraints have to be budget constraints. To make a budget constraint biting, bankruptcy has to be an eventual outcome of the failure of receipts to cover cost.

Above all, in this process what is needed is a system of meaningful prices, and, as important, a system of competition to make those prices meaningful, and to give managers choices for supply.

Therefore, in order for economic reform to get off the ground, in a sense, for the rocket to lift off the launching pad, a number of things have to be done simultaneously. This, in essence, is the Soviet problem.

At the 19th Party Conference last year, Gorbachev complained bitterly about the lack of progress in economic reform. He complained that economic officials, "gosplan" ministers continued to behave in the old way, that "gosplan" and the ministries are using state orders, these "goskhazy," to require in the old manner that enterprises produce certain items, and that focus is still on, as he put it, "His Majesty VAL," this gross output, this target.

But the problem is that the Soviet leaders want this radical economic reform, but they want it to be accomplished with a limited amount of economic destabilization. They want to maintain at least a certain level of economic stability during this transition period.

Now that is difficult.

In order to accomplish that, these old forms, these commands, these looking at gross output because that is what the ministries are being held responsible for, these old forms are necessary, to maintain some modicum of stability. And these old forms then continue as new forms are developed.

We do not really understand. We don't have a theory of transition. The Soviets do not have a theory of transition. It is really a wide open field to be developed.

The problem is how do new forms grow alongside these old forms, and what is this quantity-quality process through which the new forms will, at one point, suddenly replace the old forms.

Furthermore, the process of economic reform in the Soviet economy is a process also of spreading monetization of economic transactions. Therefore, really for the first time, since the end of the new economic policy and the beginning of the plan period, "finance" takes on a new and very important meaning.

So, this government budget, which always had problems of deficits in it, now these budget deficits become important. Now wage and inflation, as we have seen over the last year or 2 years, becomes very important.

And so, another aspect of this transition period is also to maintain some degree of monetary and price stability as you go through this process.

But one of the things that is being done is sort of new bodies are being formed, experimented with, that are separate from the main state sector. For example, the cooperatives and leasing of state property to the cooperatives—this, in my mind, is rather interesting stuff. There are joint ventures, which appear to be now taking off, in terms of numbers and value of investment in them; also discussion of free economic zones.

These are the sorts of things that may provide the competition, may provide some of the spur for the more slowly moving changes in the state sector.

Above all, in this whole process there are political issues. Gorbachev's problem is to get the reform launched and to maintain momentum as the reform is moving.

Reform is a process, a very long process, and one talks in terms of decades if one is serious about all of the modernization that Gorbachev and those around him are after.

But, what happens, as all of us have been saying, is that the difficulties come before the payoffs—the insecurity, the dislocations, the challenges to concepts of equity; a decreasing of the standard of living perhaps before it then picks up.

Here is where the whole role of the "agriculture first" strategy, that so many Western economists have been arguing about with Soviet economists that they should have taken, finally at the Central Committee Plenum last month the radical reform in agriculture at least is begun. Also there is the importing of consumers' goods, which would probably be more desirable, at least to get some immediate benefit to people, than just the importing of the capacity to produce consumers' goods.

Essentially, the function of an economic mechanism, an effective economic mechanism, is to produce rapid adjustment to changing conditions, to changing technology, to changing desires.

What this adjustment involves is the pain of dislocation.

Now, a market system depersonalizes, decentralizes this allocation of pain and benefit. Obviously, the role of government in market economies here is important, and we all, all of the democracies, market economies, have developed concepts of safety nets and other protections against, how would one put it, excess speed of adjustment.

But in the socialist economies, the government is looked upon as a mechanism to protect people against pain. This, in addition, is one of his basic problems.

What is the current situation?

It is very hard to say that economic reform is off the ground. Actually, elements of the reform are to be in place by 1991. So, it is still rather early to make a judgment on this.

Economic reform is destabilizing. Some of this is being seen—empty shelves, excess demand. But one should not ignore what has been accomplished in the way of removing old obstacles to economic reform which, in a significant way, lays the groundwork for future progress in economic reform.

Much will depend on the political skills of Mr. Gorbachev and those who succeed him. But I think experience has demonstrated that he is not a man to write off prematurely.

Dr. HARDT. I wonder if I could interject at this point that as we go into the discussion and those of you who are gathered around will want to make comments, as you do, please come to the table, so that you can speak into a microphone and be heard.

For those of you who have knowledge of statements and materials that should be included in this record, we very much want to provide the committee and the Congress with a complete record. For example, there is the new Foreign Affairs article that Alton Frye wrote with Senator Stevenson, and the more extensive materials that we have received from many people, some of whom are listed on the panel, such as Judy Shelton, but who will not be here. They have submitted statements that will be included in the record as well.

Dr. GOLDMAN. In the 30 or so minutes that remain before this first session comes to an end, let me invite both other participants sitting around the table and others in the audience, many of whom are as well informed as the participants in these matters, to come forward with questions, comments, rebuttals, objections, as the spirit moves you. Any takers? Murray Feshbach.

Dr. FESHBACH. Herb Levine mentioned in his presentation the question about price reform. But I think one has to extend it beyond price reform to a question of monetary reform. This is the enormous quantity of free liquidity that floats around the Soviet system. They had better capture that before they change prices; otherwise, there will be a major inflationary push.

One of the things that I have been discussing with some Soviets is the use of these free trade economic zones, whether it be two or three of them—Estonia, Vladivostok, whatever. There is the possibility of the use of a stock device to give amnesty so that, regardless of by what source they acquire this free liquidity, whether it be corruption or whatever, that they be forced to do it before they possibly change species, like they did during the Second World War. Otherwise, this money is going to be out there and will create a major problem.

But monetary reform, which I think is necessary also, because of the budget deficit, which also has not been discussed, I think that is major agenda item for the Soviets before they can pursue big changes domestically and internationally.

Dr. LEVINE. I think Murray brings up a critical issue. I have been testing out on Soviet economists recently the idea of would they, would Soviet economists consider doing what Adenauer did at the end of the 1940's in Germany, and that is just withdraw the old currency and replace it with less currency.

The response I invariably get is "Oh, you mean also what Stalin did in 1947."

It is not a very popular idea. But it is one of those things that if a guy is in a very powerful political position, he really could handle the problem of monetary overhang.

I must say that I have not met a single Soviet economist who thinks it is going to be done. But I think we should keep at least part of an eye on that possibility.

Dr. HARDT. I would like to introduce into this context the link between the assessment that has been made of "perestroika" and how it is going to how we might relate in our economic and political relations to the Soviet Union, or, to put it in another way, how should we, the United States and the West, react to "perestroika"? Should we praise it? How should we react?

Mr. ELLIOTT. I think the one fundamental question that needs at least to be addressed is whether it is appropriate to separate and prioritize these bilateral issues.

Undoubtedly, national security is the most important issue. But how do we define "national security"?

I think it is becoming increasingly obvious that national security has to include a very strong economic component that a secure state is an economically sound state. So, is it appropriate to put commercial issues last or to consider them separately from national security issues?

Dr. COBB. In response to both John Hardt's and Steven Elliott's questions, I think economics very much are a component of national security affairs. The way we defined it at the White House is that "national security" comprises defense policy, foreign policy, international economic affairs, and intelligence policy.

I think an East-West economic policy, to include the commercial component, should be very much defined as part of your overall national security approach to the Soviet Union, without doubt.

In response to John's question, because this is really what you probably are going to get down to later on this after—and I am not sure I will be able to come back—in devising a policy on how we react to "perestroika," John, you may recall a few weeks ago, when I was starting to get into this, I was a little confused in my mind just exactly what the components of "perestroika" were, or perhaps the broader reform program, to include "glasnost," "perestroika," and "democratizatzia."

Since that time, what I have been able to do is lay out three different types of reform programs: a conservative one, which one might say people like Ligachev, Rasputin, and others would favor; the mainstream program that Gorbachev favors; and a more radical one that people like Andreyev, Soslavskaya, and perhaps Aganbegyan and others may wish to promote, along with liberal writers, such as Korotich, when you get into those areas.

To make a long story short, it seems to me that in fashioning a commercial policy toward the Soviet Union, we should be very cautious should the Soviet Union be moving toward the conservative program, because I think that would only maintain the worst features of the old system and perhaps allow it to work better. In this case, I would not advocate a forthcoming commercial policy. I would not advocate economic warfare, but I would certainly advocate doing everything we could to make the Soviet Union feel the brunt of their own irrational economic choices.

On the other hand, should there be signs that the Soviet Union moves toward the more radical program, as called for by Andreyev, perhaps in a political club that he speaks of there, should they move into this type of direction, then I think the United States and the West, could, indeed, become much more forthcoming in their overall policy.

But I think we have to clearly differentiate as a first in our mind what are the components of these different reform programs, which ones are in our interest and in the interest of stability, and which ones are not.

Mr. COMBS. I am Dick Combs from the Senate Armed Services Committee. I would like to elaborate a little bit on the human rights component by looking at Soviet motives for their change. Maybe, Mark, you could comment on your view of this.

In the first place, it seems to me that there is a desire on the part of people like Gorbachev and Shevardnadze to have the Soviet Union seen as participating in sort of the international approach toward human rights. I think this came out clearly in Shevardnadze's July 1987 speech at the Foreign Ministry, in which he talked exactly of this, that it was important for the Soviet Union to be regarded with respect by members of the international community in the human rights area.

The second motive, it seems to me, is the perception by liberals in the Soviet establishment that focus on individuals in the Soviet Union is important for the success of "perestroika." This was stated, that explicitly, by Vadim Zagladin, when Marty Schlesinger and I accompanied the House-Senate Commission on Helsinki Matters, the CSCE Commission to Moscow, in November, for human rights discussions.

Zagladin, in his keynote, said "Well, we are interested in human rights because it is important to the success of 'perestroika.' "

It seems to me the common theme here is that this new emphasis on human rights and new responsiveness is instrumental and not fundamental; that is, it is instrumental to the Soviet image abroad and to success for "perestroika," but it does not represent a fundamental change in Soviet theory or thinking about the importance of the individual. This suggests that human rights performance is conditional on the Soviet leadership's view of the international community's attitudes and its view of "perestroika" and where it is going.

So, I think in the first category, the National Conference on Soviet Jewry and the Congress and others are to be congratulated for bringing the Soviets to recognize that international attitudes are important to them. But if "perestroika" begins to falter, or if Gorbachev begins to falter politically or physically, then I think we have to worry about the continued Soviet attitude, the official Soviet attitude, toward human rights, or if international pressure falters as well. I would be interested in Mark's comments on this, or anybody else's.

Mr. LEVIN. Dick, I would have to agree with you. Human rights does not act in a vacuum and is dependent upon not only the state of United States-Soviet relations, or East-West relations in general, but also what direction the Soviet leadership is heading in.

But I think there is one difference today than, say, 10 years ago, or in the mid-1970's, and that is Gorbachev's desire and that of the people around him, I think to really put this issue aside, but not in the way it was done 10 or 15 years ago, but to try to take it a couple of steps beyond. If you look at what happened in the late 1970's, yes, there were large numbers of people who were able to emigrate. But that was it.

The Helsinki Accords, even though they were in their early stages, received basically a cold shoulder from the Soviets and the East bloc countries in the area of human rights.

I think their reaction in Vienna and what they were willing to do in terms of making substantive progress is a marked difference.

I think what we have to do is continue to push, but also to look for more positive responses to, hopefully, keep these things going.

Whether they will or not obviously is dependent on other areas, particularly whether he will be successful or not in his restructuring.

Dr. HARDT. May I add to that that at the recent meeting in Moscow that John Rose, Aganbegian, and others chaired, the Soviets stated—and this is Korolyov and also Bogomolov—that related to "perestroika" is the importance of religious toleration, minority rights, and the reestablishment of traditional legal institutions.

Those statements I checked very carefully with those who stated them, and they identified them as their objectives. Those make this a much broader issue, domestically in the Soviet Union related to "perestroika," and also not an issue limited to Jewish emigration, which is a point that Mark has made.

Dr. BOND. I am Dan Bond, and this is a followup for Mark Levin on this line of questioning.

In the past, particularly in the late 1970's, there was a lot of focus on the numbers of emigrants coming out, and numbers were used as targets. You indicate now a concern and effort by the council and other Jewish organizations to deal with a broad range of issues, in addition to just the numbers of emigrants coming out of the country. And we also see improvements going on inside the Soviet Union in terms of human rights, with or without the council's pressure, or the Jewish organization's pressure.

Is this going to complicate the situation in terms of targets or having some kind of agreement with the Soviets about whether or not they get Jackson-Vanik or not?

Is consideration going to be given to this entire range of changes and we'll give up setting targets?

Also, based on discussions we had a couple of weeks ago, now that conditions have improved inside the Soviet Union, what do you see in terms of numbers of applications, numbers of people wanting to come out, and how will we interpret those numbers, given the changes inside the Soviet Union plus the changes in the willingness of the Soviet authorities to look at applications and deal with applications?

Mr. LEVIN. To answer your first question, I think over the years we have been very consistent and careful to maintain our belief that whether the Soviets get Jackson-Vanik or not is dependent on the original intent of the amendment, and that is emigration.

We have been very careful not to try to add extra conditions into our thinking. When we began our review and reassessment in January, we clearly stated that among ourselves, and went very public with a number of statements, as well as in recent meetings with the President, the Secretary of State, and, most recently, with the Soviets. We continue to say that we are looking at the actual numbers, the process, what will this new emigration law be when it is finally introduced, and particularly in the area of state secrecy.

All of this is specifically linked to the right to leave.

The numbers, what we are expecting is almost a threefold increase to how many people came out last year and the long-term prospects look good. However—and I will get to specifics in just a second—it goes back to what will happen in the broader context.

One can make a very good argument that not only human rights, but specifically emigration, has been tied to the state of United States-Soviet relations.

What is interesting is that there has always been a consistent interest on the part, particularly, of Soviet Jews to emigrate. Otherwise this movement would not have lasted as long as it has.

But there are a couple of encouraging signs over the last year. For one, over 100,000 Soviet Jews requested invitations from the State of Israel in 1988. That was a tremendous increase over the previous 2 or 3 years.

These are new requests. This, if anything, shows two things—the staying power of the movement, but also the new interest on the part of many who were not previously identified to us. Second, in terms of what we can expect if things continue along the way they are going, it might be 25,000 to 40,000 this year, and I would hazard a guess for what they would be for 1990.

But something parallel is happening also. The Soviets are beginning to issue visitors visas in large numbers for the first time that I can ever remember. Over 10,000 Soviet Jews were able to visit Israel in 1988, and an equally large number, if not greater, were able to come here.

Now, it is not just Soviet Jews, but other ethnic and nationality groups have also been able to take advantage of this.

So, if I can that we are optimistic, we are optimistic in the short term because we don't know what is going to happen down the line, other than what we can consider in a purely speculative form.

Dr. HARDT. May I add at this juncture the question mark as to what the changes might be if the Israelis begin to be the source of visas, as they reopen the Embassy in Moscow, and how this relates to the interaction between changes in regional policy and changes in emigration policy.

Mr. LEVIN. Let me just take 10, 15 seconds, on that because, obviously, it has a big impact specifically on this area. The fact that the Israeli-Soviet diplomatic connection has rapidly been upgrading will have a big impact on this movement, not only in terms of the issuing of the actual visa and who will get to do that now if the current Israeli mission is upgraded to a full consular mission in Moscow, but it also has an impact on what happens internally for the Soviet Jewish population. This movement would not be where it is today if it were not for the presence of Israeli diplomats between 1948 and 1967. You can almost trace the genesis of this movement to the activities that took place when there were diplomatic relations between the Soviet Union and the State of Israel.

If this presence continues to be upgraded, it is going to have a long-term impact on what happens to the Soviet Jewish population.

Mr. BROUGHER. I would also like to direct a question to Mark Levin. You mentioned four conditions that you are looking at very closely.

Mr. LEVIN. Considerations.

Mr. BROUGHER. "Considerations," excuse me, and the fact that you are hopeful that if progress continues, your working group could reach closure, as you put it, perhaps in June.

If that process eventually led toward a Jackson-Vanik waiver, would your group be concerned that this would lead to less focus on Jewish emigration? My assumption would be that the more progress we make toward a waiver, the more focus there will be on Jewish emigration and emigration in general, as Congress and others increase their focus on it. But would your group be concerned that interest would fade away over time?

Mr. LEVIN. No. I think just the opposite, because if and when a waiver was ever extended, I think at least initially there would be intensive scrutiny, not only on the part of the human rights community, but also on the part of Members of Congress as well as various components of the executive branch.

I could see quite a bit of attention being paid if an initial waiver were granted.

Mr. FRYE. I wonder if members of the panel and others in the room might address at this stage in the proceedings some fairly general hypotheses, if you will.

As we think about commercial relations in the caboose or in whatever position in the train it occupies, it seems to me that there are contending premises at work in the American debate. Those who have welcomed "perestroika" and say that modernization is a good thing, not only for the Soviets but for the international position of the Soviets, trigger a debate in which others say that is a very bad outcome. A modern Soviet Union is far more dangerous to American interests and there are negative security implications which we should use to guide our policy.

So, I would like to hear from members of the panel whether they believe that a modernizing Soviet Union, if one assumes it is possible, becomes a greater threat to American security interests, or whether the process of modernization so transforms the Soviet polity that it becomes a less threatening reality for us to cope with.

Second, in developing commercial ties potentially, the old argument of reverse leverage comes to the fore: remember the gas pipeline episode, in which much of the argument was a security calculation that increased dependency on Soviet supplies would make our allies less dependable as allies.

Is there any great concern for that kind of reverse leverage working in the commercial relationships as we see them begin to unfold? Is there a danger that we are going to be selling them that famous rope to hang us with, or is it more likely that the rope we sell them ties us together in a more constructive relationship?

Let me state my premise. However you answer those hypotheses—and I think it is important to address them—but however you answer them, it seems to me that the prudent rule is one of reversible experiments. Whatever we do should leave the United States and its allies in a position from which it can recover if things go sour.

That is a basis on which very far-reaching experiments can take place, very much forward movement can be attempted. But we need to keep our eyes open, always asking the question: If it goes

badly, how do we recover our security position? On those broad notions, I would welcome comments and reactions.

Dr. COBB. Alton has a way of getting right to the core of the issue. Alton, I go back to my differentiation, and I think this is key. I would defer to Roger Robinson later today. He may want to address this. But I think there was a prevailing assumption in the Reagan administration, which, of course, were basically very good Marxists, that the economic substructure very much did determine the political superstructure, if you will; and if fundamental economic changes were made; that is, decentralization, along the lines of which Herb was talking about earlier, and which we saw taking place in Eastern Europe, then it would be in our interest, and, in that case, we should be more forthcoming in terms of our economic policy.

On the other hand, I would assert that yes, there is a real danger that we could contribute to a continuation of a Soviet Union which maintained those aspects of its society and its foreign policy that we found most reprehensible, but that they could simply continue to believe these, to do these, but to do it better. That would be what I would call the conservative "perestroika," and I think that is not in our interest. I think that is one on which we should take a very harsh policy.

Now, on the other hand, if they were to go into the decentralization mode or more radical aspects of democratization, then I think we could certainly be much more forthcoming because in that case, you truly would be dealing with a Soviet Union that was different.

In no case, though, do I think should there be a relaxation of our strategic trade controls on real strategic trade. But I think in some areas, such as Jackson-Vanik, there could certainly be sufficient movement.

On reverse leverage, yes, I think you are quite correct. We do need to keep our attention to the types of economic arrangements that are made. We do need to monitor these. Should there be proposals which could have resulted in energy dependence upon the Soviet Union beyond which we in the Western Alliance would think was tolerable, which could have come about should a double strand pipeline have been constructed into Western Europe and some of the dependency ratios that we saw, then I think that very much would not be in our interest. I think the allies have to look at the security aspects of their economic policy as well, in order to be aware of the potential for this leverage.

Dr. LEVINE. Alton Frye brings up probably the major issue that these hearings have to face and that the U.S. Government has to face. I agree with the final conclusion, the final proposal that U.S. policy first of all be in U.S. interest, and, second, that it be cautious, and we don't jump in and burn all bridges.

Let me address just one part of the issue. It is sometimes argued that behind all that is going on now is a Soviet Government or group within that Soviet Government that is manipulating totally under its control what is going on, and that once it becomes modernized, it will pull back on "glasnost" and pull back on democratization.

I think that is a false view of what Gorbachev and those around him are attempting to achieve.

I think that the Soviet leaders have come to realize that a modern government, a modern society, a modern economy, requires human participation, requires—and this comes up over and over again in discussions with Soviet economists—requires people in the economy taking on responsibility; that one of the major problems with the past system was that people were giving orders and they had no responsibility for the consequences of those orders. You do not run a modern economy that way.

Democratization is necessary. People have to be accountable. People who make decisions have to be accountable to the public. This is part of modernization.

So, I think what we are looking down the road at, if modernization succeeds in the Soviet Union and the Soviet Union then becomes a stronger economic power, is these other components are necessary components of the modernization. Then you are looking at a different Soviet society. Then you have to ask yourself not can the Soviet leaders then take all of that back and do what they wanted to do in the first place, but what does that society look like.

I think most people would be prepared to argue—at least I would be prepared to argue—that an open, more democratized Soviet society, in which government leaders are held accountable for their action, is a society that would be a lot easier for us to live with than the present or the past very arbitrary society.

Dr. GOLDMAN. Thank you. There are some of us around the table who have additional questions that they would like to get in. In the interest of moving on with the schedule, I wonder if I might ask you, if those issues do not come up in subsequent panels, perhaps there will be an opportunity to ask them later and get to those issues in the final summing up around the round table this afternoon. Let us take a brief recess.

PANEL II.—ALLIANCE ISSUES

Dr. HARDT. The second panel will deal with the alliance system. Stanley Sloan, our senior specialist in international security, will chair the panel. He has been connected a great deal with Alliance policy, is one of the leading celebrants of the 40th year of NATO, through his articles recently, and also has published a good deal on the recent prospects of negotiations in the CFE or Conventional Force Reduction Talks.

Mr. SLOAN. This panel essentially will continue the work that was begun by the first panel in trying to paint on this very broad canvas of the background and a whole variety of issues that make up United States-Soviet relations. This will serve as the background for the discussion this afternoon, that will focus in more precisely on United States-Soviet commercial relations.

This panel will move from some of the bilateral discussions this morning and internal Soviet Union discussions to a multilateral level, to look at some of the Alliance aspects.

We are very fortunate to have a very well-qualified panel to discuss these issues. Because you have the biographies of the individual participants, I will not go into any detail on the great qualifications of Dr. Timothy Stanley, Prof. Angela Stent, and Eugene Theroux.

But before I introduce Tim Stanley to begin the discussion, I have just a couple of notes about the context, as I see it.

I think we are in a fascinating time of transition, not just within the Soviet Union, as we have heard Dr. Levine talk about in the first panel, but within Soviet-East European relations, and within Eastern Europe there are transitions that are quite important.

Within Western Europe, there is an important process of transition in the 1992 formation of a common market, a true common market, among the West European countries and the European Community.

We are seeing transitions in U.S.-West European relationships within the Atlantic Alliance, transitions that sometimes get down to the level of discussions and debates about burdensharing, but perhaps which reflect much more fundamental changes occurring in the relationship within the Alliance.

We are perhaps capturing the burdensharing perspective in transitions also involving United States-Japanese relations, and United States security policy not only in Western Europe but also in the Pacific.

I think that this convergence of transitions in so many different areas presents a variety of opportunities for the United States and for the Western Alliance. But also it is a very challenging period.

It will be very difficult for the Alliance, the Western Alliance, written broadly, to manage all of these transitions without perhaps falling out among one another about how to manage those transitions, how to deal with change in the Soviet Union, how to deal with change within the Alliance structure itself.

These multiple transitions I think form the broad background against which we would like to discuss some of the more specific issues on this panel.

So, I would like to begin by introducing Dr. Timothy Stanley, who has a wealth of not only practical experience in security issues as a U.S. official, but also a wealth of expertise on economic issues within the Western Alliance and on a global basis, and in East-West relations.

Just remembering with a little bit of sentimentality, Tim and I were sitting in Vienna 16 years ago today, as members of the U.S. Delegation to the Mutual and Balanced Force Reduction Negotiations. Those negotiations were suspended, ended, 2 months ago, and now new negotiations have begun.

So, we have moved from one period 16 years ago, when there seemed to be at least some hope for some fundamental change in East-West relations, through a whole lot of history, to another period when perhaps we can be more optimistic. On that note, Tim, I turn the floor over to you.

Dr. STANLEY. I made a deal with the moderator that I would try to talk about the issues that he has mentioned and those in the syllabus if he would let me first try to answer Alton Frye's question. I want to do that because I am disturbed by a tendency not only in Washington, but in the Alliance, to look for a single net assessment of the Soviet Union and where it is going. I think that is a mistake. There can be no single net assessment. Rather, there are alternative outcomes. And we have to be prepared, for the first time really in postwar history, to have alternative policies to deal with those

alternative outcomes. I do not want to dwell on that point because I know our time is limited; but let me just spend a couple of minutes on it and pass out this chart that I have for you. [See Dr. Stanley' prepared statement in the appendix.]

I am just trying to illustrate the point that there are a lot of outcomes. I have listed them here in a rather offhand fashion, as a cooperative or "kinder, gentler" Soviet Union as one possibility of a successful track for perestroika. That is the outcome we all would like to see. I think it is a very high-weight proposition, and a high-probability one. But it is not the only one.

Also, on the success track, there could be a modernized Soviet Union, which would simply revert to its ideological class warfare goals, its foreign policies, and be strengthened in pursuing them, and that has to be a very high negative.

People do not talk about what I call a dangerously destabilized, or "DD," model, but it is one that I think ought to give us pause. You could have a leadership which is scared, which is divided, which is fragmented, and which is in danger of losing its central command and control over Soviet military capabilities, including nuclear, chemical, biological warfare, and so on.

I think that is very remote because I think eventually the military would take over, and you would have what I call a neo-Stalinist model. But it is sufficiently serious, however unlikely, that it is one that I never hear talked about.

Having made that point, let me say that I think probably the most likely of the failure scenarios, more likely than simply a benign failure of the Soviets sinking into a mire of apathy about their own problems, would be this neo-Stalinist restoration. These numbers on the chart really do not mean much for they are all based on arbitrary values and assumed probabilities. But they do have some indicative value, and it is positive.

I think the point is important, however, that we simply cannot assume that successful perestroika is automatically good for the West, or, alternatively, that its failure is good for the West. It is a more sophisticated and discreet analytical process that I think the United States and the Alliance need in looking at this problem. This is simply one illustration of a way of going about it.

The implication of this in terms of policy is, for me, that the Alliance needs a dual-track policy. One track needs to be consciously responsive to what the Soviets are trying to do. They need to hear an echo. They need to hear some resonance from us that we understand what they are saying, we take them seriously, and we will, other things being equal, adapt our policies appropriately.

But, given the very substantial possibilities that perestroika will not succeed and that one of these unfavorable outcomes will result, we also need a second track to keep our powder dry and we our Alliance intact; and we need to have a reversibility element, as Alton Frye called it this morning.

For example, General Goodpastor has recently issued a paper for the Atlantic Council, which has been widely misquoted all over town, suggesting that NATO cut its forces in half and the United States withdraw half its forces in Europe. He said nothing of that kind. What he did say was that we should look to a medium-term mutual security arrangement in which both NATO and the

Warsaw Pact restructure, so that both sides go to 50 percent of NATO's present strength, and in that context, the United States would continue to keep at least 50 percent of its present strength in Europe.

This, it seems to me, is the kind of imaginative response that we need if we are to hold public opinion so that we will have the kind of political support that the Alliance needs.

But, having said that, we have to hedge our bets by maintaining a dual-tier military posture, which, to me, means smaller and more sustainable ready forces, sustainable both in budgetary and in political support terms, and a force augmentation, which means mobilization, reserves, surge, and so forth.

Let me give a couple of more examples.

On the economic side, I think we should suspend—"suspend" is the operative word—the Jackson-Vanik amendment, the Stevenson amendment, and the Byrd amendment. But I think we should keep them on the books, so if some of these unfavorable scenarios come about, they could be reactivated.

I think we should liberalize East-West trade. But I certainly agree with Colonel Cobb that we must concentrate on keeping control, as much as we can, of strategic technology transfers. This is because once that is transferred, it is irreversible.

Well, one could go on in this vein, but I promised Stan I would get to his three scenarios that are in the syllabus.

One is a inter-Western Alliance division of labor, in which the allies concentrated more on the political-economic and the United States concentrated on the superpower arms control issues. I think that is highly unlikely. The Europeans are as unlikely to stay out of the high policy, the arms control business, as we are to stay out of the commercial end.

The second scenario involved a consensus, which I think is also unlikely, partly because of the coincidence of these three evolutions that Stan mentioned—not only in Eastern Europe, but in Western Europe and the Japanese relationship.

That this widely diverse group of countries can maintain a complete consensus and a master plan of action I think is highly unlikely. The Europeans, with the exception of the Scandinavians, and perhaps the Dutch, are simply not as interested in human rights as is the United States. They do not see this as a traditional element of international diplomacy.

Second, as we all know, the European trade patterns are much more geared toward trade with Eastern Europe and the Soviet Union than are ours. A year ago, Dr. Lincoln Gordon and I did a paper called "Integrating Economics and Security in East-West Relations," and we came up with a table of coefficients of foreign trade, which simply took the total of the sum of exports and imports as a percent of gross national product. Both ours and the Soviet Union's are very low (Eastern Europe's are higher); whereas most of Western Europe is up in the 30, 50, even the 70-percent bracket. But we are down in the 5- to 10-percent bracket. So, here is another fundamental divergence. If you then assume that we are not going to have a single united Western policy, that we are not going to have a clear division of labor, then we are going to have,

as the paper suggests, a range of individualistic commercial approaches.

But that said, I think we should keep them as common as possible. I think we should try in every way we can to honor the gentlemen's agreements that have been reached in NATO and OECD to keep East-West trade on a commercial basis. Credits? Yes, possibly with government guarantees, but not government subsidies.

So, I think it is possible to maintain a sophisticated approach to the possible Soviet outcomes, a sophisticated, two-track approach to Western policy, and to pursue simultaneously policies which are responsive and have resonance for the Soviet Union, and those which keep our powder dry.

Mr. SLOAN. Thank you very much, Tim, for a very useful and stimulating strategic perspective on the wide variety of issues that are coming together and that we are trying to deal with in this panel.

Clearly, the United States will need at some point some kind of clear strategic perspective, perhaps something like the one you have suggested.

One of the problems in implementing a strategic perspective will be getting all of our allies to go along the same path. That is the topic that Angela Stent will address in general terms, and will hopefully reveal some of the difficulties that we will experience down that road.

Angela brings to this panel just the right combination of expertise with her work on the Soviet Union and Eastern Europe and her knowledge about Western Europe and how the United States and West European nations have historically and at this moment some differences in dealing with these issues.

Dr. STENT. By the way, the two-track policy that was being described, of course, to my knowledge, has been the official policy of NATO since the famous Harmel Report of 1967.

My first point is self-evident, and that is that Gorbachev has had a major impact on Western Europe. He is arguably more popular there than he is anywhere else in the world, including at home, since West European citizens do not have to stand in line for sugar or soap.

He is popular because he has embarked on a dynamic, innovative, much more conciliatory policy toward Western Europe. He has convinced many West European citizens that the Soviet threat has significantly diminished, if not entirely disappeared.

I think he has persuaded most West European governments that the West has to respond more actively and more dynamically to Soviet moves, and also that the West should encourage Gorbachev in his attempts to reform the domestic economy in "perestroika" and in "glasnost." Therein, of course, lies a major potential problem for the United States.

Gorbachev's policy toward Western Europe embodies many traditional elements of Brezhnev's policy, only revived and made more effective. But the theoretical underpinnings are new. They are based on Soviet new thinking, which we have read and heard a great deal.

As far as Europe is concerned, the most important element of new thinking is the theme of "Europe: Our Common House."

This concept is still very vaguely defined, but it is clear that the major reason why Gorbachev is encouraging closer links between the two halves of Europe is his desire to enlist West European help in shoring up the faltering East European economies, and securing a West European commitment to stabilize the situation in Eastern Europe. He is prepared to permit considerable political change and flexibility in Eastern Europe in the pursuit of this goal, as we have seen with what is happening in Hungary and in Poland, if that flexibility is the price that the Soviet Union has to pay for greater economic stability and greater West European involvement in Eastern Europe.

He hopes that this greater West European involvement will enable the Soviet Union to avoid ever having to decide in the future whether it is going to have to invoke the Brezhnev doctrine again. He is hoping that this common European home and the policies that the West Europeans pursue will make the Brezhnev doctrine obsolete.

He is also emphasizing the theme of "Europe: Our Common Home," because he is concerned about the effects about the effects of the single European market of 1992 on East-West European economic relations. He is concerned that the Soviet Union will be left out of this process and may do worse economically from it.

Now, what about the U.S. presence in the common European home?

Can the United States rent rooms? Will it have a lease? Might it be ejected at short notice? When you read Soviet writings on this, they wax quite eloquent. It is fun to read them.

There has been an evolution in Soviet thinking on this issue. Initially, the Soviets claimed that the United States did not really want to be in the common European home.

Now some of them are writing that the United States is "an organic part" of Europe.

At the moment, I think Gorbachev, like Brezhnev, and like even Khrushchev, realizes that a United States presence in Europe stabilizes the division of the continent, and it is preferable to the unpredictable consequences of a United States pullout and a possible militarily revived Germany or Franco-German military cooperation.

Now, what has Gorbachev done in terms of European policy? We know what he and his advisers have been writing.

The most visible aspects are, of course, the INF agreement, with the significant concessions that the Soviet Union made; the revival of relations with West Germany; the agreement between CMEA and EC; the upgrading of Socialist and Social Democratic parties, and even of religious peace movements, and the downgrading of Communist parties in Western Europe; and, of course, the intensified search for economic relations with Western Europe via joint ventures, where, of course, the West Germans have taken a leading role, after the Finns.

Well, how do our allies view the Soviet Union under Gorbachev?

Of course there is no unified view, and the Germans are more favorably inclined than are the French or the British in some areas. But, in general, the West Europeans share the view of German Foreign Minister Hans Dietrich Genscher. I know in this

country "Genscherism" is sometimes used as a pejorative term. But in Western Europe it is not so.

Genscher set out in a landmark speech in 1987 a theme which he has repeated again, that we should take Gorbachev at his word and do everything to encourage him.

Most West European governments would agree that the West has to be vigilant in defense of its own security. It obviously should not disarm completely. It should not forget about security.

But most West European governments, conservative and socialist alike, are skeptical that the Soviet Union represents any major threat to Western Europe. Even the late leader of the West German Christian Social Union, Franz Josef Strauss, not known for his love of communism, returned from a trip to the Soviet Union in January 1988, and essentially said that there was no Soviet threat anymore. It had disappeared.

In general, our allies say they would like to develop a coherent, jointly endorsed, active Western policy of responding to Gorbachev. I agree with the previous speaker that this is probably very difficult. But at least this is the direction in which they would like to move.

Gorbachev has made a number of conciliatory gestures, including the recent announcement of unilateral troop reductions, withdrawal of troops from Eastern Europe, and the West Europeans feel that the West has to reply to this.

Ideally, I think they would like to coordinate their policy with the United States. But I think they also fear being overtaken by events. They fear public pressure on them, and I think that they will try to pursue a European policy separate of the United States if need be, and that is already happening in some economic, and even political, areas within the European Community.

Gorbachev, as you know, has already been in the United Kingdom this month. He is going to visit France, West Germany, and Italy later on this year. Clearly, this year, 1989, is one in which he intends to pursue very actively his common European home policy, his dialog with the West Europeans.

What are our allies' major concerns in relations with the Soviet Union? This is one of the questions we were asked.

Obviously, in the security field, there is disagreement about the modernization of short-range systems, with the Germans holding a somewhat different view on this than some of our other allies.

In terms of human rights, while I agree with the previous speaker that these have never been as important for the West Europeans as they have for the United States, from the West German point of view, there is an active policy of encouraging emigration of ethnic Germans from the Soviet Union and Eastern Europe.

Last year, the Soviets allowed an unprecedented 48,000 ethnic Germans to emigrate. The East Europeans, particularly the Poles, have greatly liberalized their policy. But, interestingly enough, this has produced a domestic backlash in West Germany, where there is increasing resentment against immigrants, including those from Communist countries, which has partly fueled the resurgence of extreme rightwing movements.

However, the German Government I think will continue to pursue this policy for the foreseeable future.

They are also trying to tie economic relations to improved conditions for those ethnic Germans who remain in the Soviet Union and Eastern Europe, to obviate the need for emigration. As we heard, the Jewish organizations in this country are also concerned about those Jews who stay in the Soviet Union.

For instance, in 1987, a 1 billion Deutschmark loan to the Hungarian Government, which enabled the Hungarians to avoid rescheduling their debt, was specifically tied to improving the living conditions and the freedom of expression for ethnic Germans in Hungary. This policy is being pursued in other countries.

Let me just add that it is clear that the West Germans have the most active and coherently thought out policy toward Eastern Europe. Maybe West Germany is the only Western country that does have a coherent policy toward Eastern Europe.

The Soviets welcome this at the moment, again, largely for economic reasons.

Now, how does this impact on their economic relations with the Soviet Union and Eastern Europe?

All West European countries are generally in favor of increasing their economic cooperation with the Soviet Union and of doing this in order to encourage Gorbachev. The West Germans, for instance, have now started training Soviet managers in West Germany. Other European countries are going to do the same thing. And, from the Soviet point of view, this is particularly important to give Soviet managers the potential skills to improve economic performance.

Traditionally, of course, we have disagreed with our allies over the politics of East-West trade, over questions of sanctions, and other issues. These disagreements will continue, I predict.

Our allies would look very unfavorably at any United States attempt to curtail credit granting to the Soviet Union and CMEA, and they are much more vocal now about the need to reassess COCOM controls.

The whole question of 1992 is up in the air. Can you still have national export controls when you have a single, unified market? There is no agreement on this.

Our allies are particularly I think annoyed that the United States has not moved to rescind the "no-exceptions" rule for the Soviet Union since the Soviets have withdrawn from Afghanistan. There are also discussions on the role of the newly industrializing Pacific Rim countries, how they should be tied into COCOM, and continuing questions about the rationale of controls on so-called dual-use civilian technologies, definitions of "technology"—all the traditional questions, which I think have been exacerbated under Gorbachev because you have a Soviet Union that appears to be much more conciliatory and reasonable.

There are complaints now that the United States is dragging its feet in general on revising COCOM lists and reassessing COCOM's role.

Could there be future pipeline disputes? This is one question we were asked to discuss.

I think it is possible, particularly if the United States were again to invoke extraterritoriality. It seems to me that all of the major issues that were involved in the 1982 dispute have not really been

resolved within the Alliance. They simmer there. They have not come to the fore recently. They could come up again.

They involve basic questions, of course, of the economic and political relationship with the Soviet Union.

I think another major debate that the United States and its allies will have to continue to engage in is what our policy toward Eastern Europe should be. Should we be helping to stabilize Eastern Europe, as Gorbachev would like us to? Should we encourage change? If so, what kind of change? And how much is it in our interest, in fact, to have change that might be potentially destabilizing?

The EC itself does not have a united position on this, but the West will continue to have to thrash this one out in its own discussions.

Finally, let me come on to the question that was already addressed, of a division of labor between United States and Western Europe, in terms of economic-political relations and strategic.

I think it is obviously impossible to have such a neat division of labor. I think the West Europeans want to have a U.S. leadership role. They feel uncomfortable with the idea of taking too many initiatives without the United States. But they will continue to prod the United States in more conciliatory directions vis-a-vis the Soviet Union, that correspond more to their own policies.

Let me finally leave you with the thought that one Soviet expert gave me when I was last in Moscow. He said—and he was quite happy about this—"By the year 2000, there will be two economic axes. One will be the United States, Japan, the Pacific high-technology axis. The other will be the Soviet Union, Eastern Europe, and Western Europe low-technology, traditional industries axis, and both will be quite successful, and this is how the world economic system will evolve."

Well, I am sure that our allies do not look upon this prospect with very much enthusiasm. But it is something I think from the Soviet point of view would be a great improvement on the current situation.

Mr. SLOAN. Thank you, Angela. You have made it clear that, once again, West Germany is at the center of many of these issues, and that there are many differences on a European basis between the United States and Western Europe. The complexity of course goes even deeper in that if you characterize the German attitude as being one of Genscherism, that we should take Gorbachev at his word, my sense is that the French attitude is that we should not take Gorbachev at his word.

So, even within Europe, there are great variations on how to interpret the nature of change and how to respond to it.

In looking at the Western Alliance, defined more broadly, have to take into account the views of Japan.

We are very fortunate to have Gene Theroux here today, who is a practitioner in East-West trade, rather than a student, as many of us are students of these issues.

Gene is a practitioner and is very experienced in United States-Soviet trade relations. He has recently been to Japan and has some perspective from his visit there that he would like to pass on to us.

Mr. THEROUX. I was interested in Dr. Stent's concluding comment about the Soviet Union and its view of the two axes, the Western European, Eastern European, and Soviet Union being one, and the United States and Japan—with its high-technology—forming the other.

But, of course, the Soviet Union, as I look at the map on the wall, has territory extending eastward to enable it to be considered for that other axis too.

My comments will be very much a groundlevel view. I am a lawyer in private practice in the international arena. The study of these broad policy issues is not my daily work. I will concentrate my few remarks on the Pacific area, mainly Japan and China, in relation to the U.S.S.R.

Experience has shown me that I have been very much mistaken on any predictions that I have made about large policy issues.

I went to China the first time in 1972, with the House minority and majority leaders. We came back and made a report to the Congress that, among other things, China would never be interested in foreign consumer products, never be interested in joint ventures, never pay royalties for technology, never allow foreigners to participate in any exploration or any other fashion in connection with raw materials, petroleum, metals, and minerals that might come out of China.

In 150 or more visits that I have made to China since then, and over the 5 years that I have spent on the aggregate on the ground in China since 1972, I have participated in transactions involving all of these things—from M&M's sold on consignment, to joint ventures involving Pepsi Cola and Kentucky Fried Chicken, to the fabrication of McDonnell-Douglas civil airliners in Shanghai. This experience ranges right across the board: cosmetics, chewing gum, soft drinks, confectionery products, pantyhose, and the like, capital goods, high-technology products, and so on.

This experience has been enjoyable and stimulating, but quite different from what I could have predicted, from what anyone might have predicted, in 1972.

So, now, as we look at the Soviet Union, again, I look at it from perhaps a different though still very much a beginner's perspective. As far as the Soviet Union is concerned, my experience with China compels me to be at least open to the possibility that very dramatic changes could occur.

I was in the Soviet Union most recently, about a week and a half ago, having arrived there from Tokyo. So, let me talk just quickly about Japan first.

Many observers wonder to what extent the Japanese will participate in trade and investment with the Soviet Union, and generally in foreign economic relations of the Soviet Union.

There are today a great many Japanese business representatives stationed in Moscow, as visitors there can testify. There are several hundred of them. They greatly outnumber the Americans, and I would guess they outnumber all of the U.S. and European representatives combined. That is my guess, based on very unscientific observations.

Perhaps I should not be surprised that a number of Japanese business representatives in Moscow are fluent in English, obviously fluent in Japanese, and also fluent in Russian.

They seem to know the U.S.S.R. well. Typically, they have been assigned there for a long period of time, I have discovered—not for 1 or 2 years, or even in the short time since the U.S.S.R.'s joint venture law appeared, but for a much longer period of time.

However, there have been very few joint ventures concluded between Soviet and Japanese enterprises to date. This subject arose at a meeting that I attended in Tokyo on March 29 and 30.

That meeting, incidentally, was originally conceived as a conference on doing business with the Soviet Union, sponsored by the Keidanren, a well-known Japanese organization, and Baker & McKenzie, my law firm.

Late in the planning process, the U.S.S.R. Chamber of Commerce and Industry learned of the meeting, at least I believe they learned of the meeting. In any event, they suggested a similar meeting on the same topic for the same dates to the Keidanren.

It was agreed among the three organizations to make it a three-way meeting.

The meeting took place on March 29 and 30 in Tokyo, on the subject of doing business in the Soviet Union, cosponsored by Baker & McKenzie, the Keidanren, and the U.S.S.R. Chamber of Commerce and Industry.

There were about 75 Japanese companies represented, mostly large firms, and about a dozen Soviet officials from Tokyo, and about 15 or more Soviet representatives from Moscow, 1 from Vladivostok. Several of these had come just recently from Seoul, South Korea, where the U.S.S.R. Chamber of Commerce and Industry had established a trade liaison office.

I was interested in the discussion at the Tokyo conference—from the perspective of an observer of the byplay between the Japanese and Soviet participants. Without going into a long report about the meeting, I think you might be interested to learn that the Soviet side—"baited" would be too strong a word—invited the Japanese to explain why there has been so little direct investment on the part of the Japanese in the Soviet Union.

The Japanese responded by saying, pretty much to a person, that we are not as interested as you may think, and we are not likely to be very much interested as time goes on. The things you have to trade with us, or sell to us, or to allow us to invest directly in are not as interesting to us today as they might have been in the past.

It reminded me of a cartoon I drew at the time of a pique of United States-China commercial relations, where one businessman was facing a formidable looking Chinese counterpart across the table, and saying, in exasperation, "We're not as euphoric as you think."

The Japanese were making that point. They are not as euphoric about prospects in the U.S.S.R. as the Soviets would like them to be. Some Japanese told me privately but would not say this publicly at the meeting, or at least did not, that their concerns—which I am sure will not surprise this group—relate to the territorial disputes, the islands disputes, that Japan has with the Soviet Union.

The day before the Tokyo meeting took place, in fact, I saw what I thought was a very provocative news story in the Japanese press. It was to the effect that U.S.S.R.'s Mr. Rogachev, who had been recently in Tokyo to talk about these islands disputes, had returned to the Soviet Union to where he told the press that the islands in question had been first discovered, and first settled, by people from the Soviet mainland. The same newspaper, incidentally, carried that same day a separate story on Japanese sailing vessels of the 12th century, which were exploring the whole reaches of the Pacific.

So, I don't think anyone in Japan, at least, was persuaded by Mr. Rogachev's point of view, and I do not think the Japanese could ever be persuaded that the Soviets first discovered and first settled those islands.

But, nevertheless, Japanese business and some government officials who attended the meeting are of the view that while these are questions in which the Japanese position cannot be compromised at all, there is hope for an amicable solution with the U.S.S.R. because discussions are being undertaken on a regular basis with Soviet authorities. And so, the outlook for resolution of that territorial dispute is reasonably good.

I do not think myself, though, that that settlement of the islands disagreement will necessarily mean great progress in the commercial area. Significant Japanese investment in the Soviet Union in joint ventures or in similar kinds of projects that require investment of money is likely to be modest. Significant Japanese investment has not occurred in China, where the largest foreign investors in China are companies from the United States. There is a large amount of trade, of course, between Japan and China.

As with China and Japan, one can see that there are some very complementary interests and potentialities between the Japanese and the Soviets on exchanges for raw materials, for finished goods, for high-technology and capital goods. But, so far, the business relationship has been more a trading than an investment relationship.

I do not expect that to change.

In fact, in response to a direct question by a Soviet official to a Japanese businessman at the Tokyo meeting, on why there has been so little Japanese investment in the U.S.S.R., the Japanese gentleman replied that the Japanese don't want to be first among foreign investors in the U.S.S.R. in any event. They want to be second, or maybe third, to learn from the experience of others.

I suppose China comes under this workshop's heading of Alliance issues, although not in the same sense as a NATO country might.

There seem to me to be some very obvious mutual benefits to be derived by increased Soviet-Chinese trade and commerce. The great need in the Soviet Union, as we have heard already today, is for consumer goods. The Chinese can produce manufactured consumer durables and textiles in abundance to such an extent, in fact, that they have been the target of a number of antidumping proceedings in the United States and Western Europe.

There would seem to be a ready market in the Soviet Union for all that China can produce, and the Chinese have some needs which could be met by the U.S.S.R., particularly at a time when both are conserving foreign exchange.

So, maybe we will see some progress toward that kind of commercial relationship at the time of or after the Sino-Soviet summit planned for Beijing in May.

Just quickly, on Korea, as I mentioned, the Soviet delegation that visited Tokyo in late March had just come from Seoul. They made no attempt whatsoever to disguise from their Japanese audience the fact that Korea had been their first stop.

The Soviet visitors reported that the Koreans are keenly interested in developing trade and investment relations in the Soviet Union, and from other reports this seems an accurate picture. I tried to get a meeting with the head of the Legal Department of the U.S.S.R. Ministry of Foreign Economic Relations in Moscow on a recent trip there and had to wait several days because he was fully occupied with delegations from South Korea and Taiwan.

There are not plans to stage a conference on the U.S.S.R. like the one my law firm cosponsored in Tokyo in March 1989 in Seoul, Korea, in 1990, where I think the audience might be even larger.

North Korea I cannot speak much about. I have never been there. I have heard—and it seems to be accurate—that though the Chinese are improving relations with the Soviet Union, and so are the Japanese to an extent, and so are the South Koreans, the attempt on the part of some of those countries to neutralize North Korea or moderate its policies may not be terribly successful. The North Koreans seem pretty much intending to go their own way, much the way Albania once did, and as Romania seems to be doing now.

I cannot speculate on that, but it is an issue that you experts here perhaps should address.

Finally, just a quick word about the possibility that has been raised in Japan, in the United States, and in the Soviet Union, and elsewhere, too, about the development of the Soviet Pacific Coast, and the placement of special economic zones or some other types of trading and business zones there.

This is a subject that seems to interest officials with whom I have talked about this subject quite a good deal.

There has been reasonably good experience in China with special economic zones, and some reasonably good experience in Hungary with special economic zones.

Most American experts that I have talked to about the possibility of special economic zones in the Soviet Union tend to disregard them as having any potential significance, and for a variety of reasons. I don't share their pessimism.

Such zones have been proposed in the Baltic States, and there are reasons why people think they would, or would not, work there. I am not qualified to address that, really. Based on my observation of a very dynamic Pacific basin over the past 20 years, I do believe there is good potential for development, including special economic zones along the Soviet Pacific coast. I do not think that if the Japanese investment does come to the Soviet Union, and if the Korean investment does come, and United States investment too, the Soviets can succeed with a major effort to develop manufacturing and export zones around Vladivostok or other areas of the North Pacific. This could necessarily involve deep water port and airport development.

I think back to when the Chinese established their first special economic zone, in Shenzhen, in Guangdong Province, near Hong Kong. I visited Shenzhen, and it reminded me, although I had not been there—so I cannot really make the comparison as a firsthand observer—but it suggested to me the Alaskan Gold Rush town that we have read about. The streets were just ruts and mud holes. There was nothing at all going on in Shenzhen. Not many people thought that much would come of it.

But it has become a showcase special economic zone for China. It has been a source of significant foreign exchange revenues. Some large, as well as many, many small companies have established themselves there. Pepsi-Cola, for example, one of the first American companies to establish a joint venture in Shenzhen, now supplies Hong Kong with Pepsi and Pepsi products from that location.

Pepsi was told at the time its Shenzhen joint venture was established that only a maximum of 20 percent of its products could be kept in the special economic zone, that none could be taken into China from there, and that 80 percent must be exported. That has changed. Now the market in Shenzhen and the surrounding areas of China for Pepsi products has been such that it has pulled those products out of the special zone into China "proper," if I could say that.

So, in concluding, while I have no specific predictions to make, or any significant policy insights, I would say that in considering United States-Soviet commercial relations, we should not rule out anything.

I would go back to my opening comments, and say that I could not have dreamed what has happened in China or in United States-China relations since 1972. None of us, I believe, could have. I had not intended to quote Chairman Mao, but he did say, "Emancipate our thinking and emancipate the mind."

When we liberate our thinking about the Soviet Union, and the potential of its commercial relations with the United States, perhaps the sky is the limit.

Mr. SLOAN. Gene, thank you for broadening our perspectives to even beyond Alliance issues, to multilateral perspectives, perhaps, and also giving us some on-the-ground reflections on what this all comes down to. You get it on the interpersonal, intergovernmental, and interfirm level.

I think you also convinced us that one should never say "never." I guess that is probably a good lesson as well.

Now we will move to discussion and questions from the floor. Comments from the floor will follow the same procedures as in the first panel. The procedure is if you would like to speak, please move to a microphone to do that. Second, also please identify yourself.

Dr. HARDT. As this is the day that President Bush talks about the results of the roundtable, I would like to add a question related to the Soviet policy toward Poland, and indeed Hungary, and also U.S. policy toward both of those countries in the context of changes.

If the roundtable is successful in its implementation, we may, on the one hand, find that in the election after next, the Polish Work-

ers Party will no longer be a dominant party. Presumably, the Soviets are willing to live with that expectation.

We have testimony from leading Soviet officials in Hungary that neutralism in Hungary is not against the Soviet interest and the threat to them.

On the other hand, the Soviet Union seems to feel that for each of those countries, the way out of their economic problems lies here—"here" being the International Monetary Fund, the World Bank, the United States, and the Western Alliance.

Is this a correct reading of the policy? How does that square with the scenarios that you worked up?

Dr. STENT. My impression—and, again, this is partly from what I have read and also partly from taking part in the first, I guess, United States-Soviet Conference on Eastern Europe in which Soviet and United States academics and government people took part—is that the Soviet Union, or the more enlightened people in the Soviet Union are so aware of the disastrous economic situation in some East European countries, particularly Poland—Hungary is obviously not quite of the same magnitude as Poland—that they really are willing to tolerate a wide variety of what we would have thought 5, even 3, years ago, just impermissible, a wide diversity there, including the possibility that after the next election Lech Walesa could be the President of Poland. That seems a little hard to imagine—or that Hungary could join the West European Union, which, of course, it has asked to join, and declare that it is neutral. These are sins for which the Soviet troops invaded in 1956.

But the imperative, again, of stabilizing these economies, getting them to work properly, is so great that there is much greater agreement to tolerate diversity.

But there must be limits to this.

I do not think that the Soviet Union, under Gorbachev, has thought out clearly what these limits are. I think it would be preferred not to face the question of what the limits are.

But if you get a real erosion of the leading role of the Communist Party in Poland, I think most of us who have studied this area for a long time would be skeptical that the Soviets would be willing to permit this. If they were willing to permit this, this would, in essence, be a "Finlandized" Poland—if the Communist Party loses its leading role, if the "Nomenklatura" collapses, you know, as the system is practiced today.

But we have just heard that anything is possible.

I think the Soviets would prefer to have systems in Hungary and Poland that still maintain some semblance of a resemblance to the Soviet system, as it will evolve—but we are not quite sure how that will evolve—while welcoming as much Western assistance to stabilize these systems as possible.

I think that still does not answer the question of the extent to which the West should get involved in this. Some people in the United States think we should not do anything to stabilize the situation there, even if Poland and Hungary move toward a somewhat more liberal system. Again, we heard that this morning from Ty Cobb, the Soviets should be forced to face the consequences of their economic and political systems, both in the Soviet Union and Eastern Europe.

Mr. MIKO. I would just like to comment on something Angela Stent said, not in any way to disagree, but maybe to add another refinement. I think it shows Gorbachev's sophistication.

As you said, Gorbachev, in discussing his common European home, explicitly includes the United States. In fact, I think in some ways the Soviets are bending over backward to make that point.

It occurs to me that what may be happening is Gorbachev recognizes that for Western Europe to dare to move toward that all-encompassing cooperation that the Soviets are hoping for, they need that American security blanket, and that, in fact, the long-term trends, if they leave it all alone, will be in the direction of eventual evolution of the United States out of Europe, so that they do not need to put any pressure on.

In the meantime, for instance, the Germans whatever doubt they might have about going in this direction, if we are holding their hand while they are doing it, those will diminish considerably.

Just one other point. You talked about Gorbachev's popularity in Western Europe. That certainly is a problem for us. But I think it is also a double-edged sword for him because, at the same time that they like him so well, it comes with certain expectations, assumptions, and so forth, which will make it much harder, much costlier for him to reverse course.

It just occurs to me in that context that the most pro-Gorbachev in the Soviet Union are the Baltic States. But that is not without its problems for Gorbachev.

I just want to ask Tim Stanley one question. You mentioned that we should be very careful about controlling strategic technology to the Soviets. But do you think we can do that?

Dr. STANLEY. Well, we can certainly do it if we can define it. That has been the problem, as you well know.

One man's militarily dangerous technology is another man's peaceful bit of technology.

It is not an easy question. As you know, the Pentagon and the Commerce Department have been wrestling and fighting with this issue over the years, just as far as U.S. unilateral controls go, let alone what goes on in COCOM.

The tendency has been to try to solve the problem by narrowing the list, by defining it more sharply and building higher fences around fewer and more important technologies.

I think if we go that route and are able to identify those that are militarily critical; that is, that will have not just a marginal, but a central significance, in terms of future development of major Soviet ballistic missile defense, or other high-technology systems, and concentrate on those, I think we can do it, yes. But the question is can we distinguish.

Mr. FRYE. It is the nature of a reciprocal relationship that it works in both directions.

I wanted to follow Francis Miko's comment in regard to Angela's observation about the new, or fresh, Soviet perspective on the United States as an organic part of the common European home.

I think it is quite plausible that in Moscow, the more sophisticated insights have taken note that from a Soviet standpoint, the connection to Europe is a tempering connection for American policy, and not only in Europe, but elsewhere.

If you are asking the question from the vantage point of Moscow, how is the United States influence to behave in the Middle East, one notes the different nuances in European Community policy regarding the Middle East.

If you ask how is the United States made more cautious with regard to such episodes as bombing Libya in response to terrorism, one notes that not many allies participated in that venture, or cooperated in it.

So, I think the other element of the insight is that by keeping the United States connected to Europe, by welcoming that, actually Moscow could well calculate that they are softening, tempering, or moderating American policy in many parts of the world, and I suspect that is a sound insight.

Dr. STENT. Let me just say that that is a very important aspect of Soviet policy toward the Western Alliance; that is, being sure and banking on the fact that our allies often do put pressure on us to moderate our policies, and also in the East-West trade area. Often this pays off for the Soviet Union.

Without those links exactly, American policy in various areas of the world would be much more incalculable.

Mr. THEROUX. I have just a brief comment. Dr. Stanley spoke about the difficulty that we have in defining what are strategic exports and the control of them. I have just a small observation. Again, those of you who have recently visited the Soviet Union may have had a similar experience or two.

Westerners, Americans among them, are running in and out of the Soviet Union with portable PC's. I recently came back from there. I happened to sit beside a former U.S. Government official who was very concerned about this, and perhaps rightly so. He doubted, and I doubt, too, that anyone bothers to get an export license these days to take a personal computer to the Soviet Union to help them get through a joint-venture negotiation, where there are no typewriters, and where you cannot have a photocopier in the Soviet Union without a special license.

So, these things are coming in and out of there. I was reminded once again of how difficult it is to maintain effective controls, no matter what the policies, rules, and regulations are.

That subject was covered at our meeting in Tokyo, and there was very rapt Japanese attention to that subject, by the way. One of my law partners covered that subject in his very extensive paper on export controls and COCOM controls. It was a best seller.

Dr. MROZ. I think a lot of us who deal with East-West relations on a day-to-day basis are concerned as much with the West-West implications as we are with the East-West implications.

I have three particular phenomenons that I think are possible that I wonder if some of the panelists would respond to.

The first is the German question. Let's be honest. It is coming back onto the agenda after several decades of being agreed to on both sides that it would not be on the agenda. Anyone who talks frequently to East Europeans, to Soviets, to French, and to others, know that it is coming back on the agenda.

The other day, recently, I heard in an interesting way from the Czechoslovakians protesting to West Europeans as to why the GDR

should be allowed to be the honorary member, the 13th member, of the EC due to their special economic relationship with the FRG.

I wonder what do you see, as this begins to come back on the agenda, as the conventional force talks in Vienna and other things show us that one has to tie the German question to almost everything we are talking about.

The second is this: In terms of the changing perception of threat, I think some people have alluded to the fact that there is a changed perception of threat, I would assume not only in Europe, but also in the United States and the Soviet Union.

There are other things which are being introduced into the debate in the Soviet Union which I think can further separate West European, in particular public opinion, from their lead opinion in some cases.

For example, a number of people in the Central Committee in the Soviet Union recently expressed a serious concern that they are going to be unable to stop in the Soviet Union a national debate on a volunteer versus a draft army, a volunteer army of 2.5 million. The argument so far being used by the military is 100 percent economics. Nobody is discussing this as a security issue.

The Chief of Staff of the Soviet General Staff got on television recently and said "Well, this is a very interesting proposal, but we all know this would be four to five times more expensive than the current cost of maintaining our military because right now, we don't pay our soldiers very much and look what we will have to pay them."

Now, a group of economists, including several who have just won the election on March 26, take issue with that and say that they can prove economically that the Soviet Union would save a significant amount of money.

I wonder what kind of impact that will have on public opinion, as well as in some of our own assessments as to how the West should respond.

On naval issues as well there are some other interesting examples.

The final point is on the democratization-stability-change cluster of issues. As we listened this morning to talk about emigration of tens of thousands of particular groups of Soviet citizens, the Jewish community, Armenians, Germans, and others, I wonder what, from a political point of view, on the congressional agenda, is going to happen—which I think a lot of people feel is inevitable—when the Soviet authorities in Moscow are going to have to crack down in very tough terms, in the Baltic Republics, in Georgia, perhaps in the Ukraine and other areas? What is going to be the nature of that reaction, not only in our country, but also among our allies?

I can envision different reactions, very different reactions, coming from different quarters. How do we begin to deal with that, which we all know is one of the ultimately most sensitive issues of how you begin to deal with internal Soviet questions?

Do they become human rights issues? Do we put them on the agenda? What does that opt for in terms of West-West relations?

Dr. STENT. The German question has always been on the agenda. You are right that it is more a question of public debate now, I suppose because the West Germans themselves are discussing it more

openly, and they have been more reserved about doing it previously.

In fact, I went to a discussion with one of the leading officials in the Federal Republic responsible for this, who came out with a somewhat astounding statement, that if you Americans think that we have given up on German reunification, you are wrong, and, by the way, you always say that Moscow is going to decide German reunification, but you are wrong there as well. Washington is going to have a big role to play in it.

On the other hand, there are other German officials who will say that this isn't really a major issue, and certainly public opinion in West Germany indicates that among the younger generation, and I mean the postwar generation, there is no massive feeling about the need for German reunification. It is something that has to almost artificially be kept alive by the political authorities.

I don't think this is true in East Germany. I think there is probably much more interest there in the question of reunification than there is in West Germany. All of the public opinion polls, however, are confusing because it depends on how you ask the question.

Let me turn to the Soviet side of this now. Despite some of the hints that Gorbachev has made to German officials, including saying that it was Churchill and the Americans that were responsible for the division of Germany and in a hundred years, we'll see what will happen, despite the fact that some Soviet officials have hinted that the Berlin Wall may come down.

I do not think that the Soviets, until now, have revised their policy on Germany. They have had a group studying this. They are discussing it, and they will use a traditional policy of making hints to the West Germans about possible closer relations between the two Germanys if the West Germans were to do X, Y, and Z.

But I would say there has been no fundamental Soviet reassessment of policy toward "the German question," if we mean by that reunification in return for a neutral West Germany, let's say.

So, I think this is something, although it is on the agenda, to some extent it is the Federal Republic that wants to keep this question alive for domestic political reasons, too. But I would not envisage any major change in this area, nor do I think that the Berlin Wall is going to come down for some time.

If I could just skip, I would deal with the last point on the democratization.

I think you have raised a very important issue, which is, if you rescind Jackson-Vanik and Stevenson and you take a more flexible policy, what do you then do if the Soviet Union does use force to crack down, be it in the Ukraine, Georgia, or wherever?

I think the West European reaction to this, if we base it on past experience, is you don't do anything. You continue your trading relationship. You can verbally deplore what has happened, as the French would probably do, but you don't do very much.

I think in the United States Congress, there would be moves that you have to take action, and, therefore, you have to develop a policy that leaves you with levers to use or "sticky carrots," as they have been called—incentives to the Soviet Union, which can then be withdrawn.

But I think there you would have allied disagreement on how to react to, say, a military crackdown in any of the ethnic borderlands of the Soviet Union.

Dr. STANLEY. I would like to quickly address the question you asked about the debate over an all-volunteer force, in effect.

I think the significant thing is that a debate is taking place, quite apart from the cost considerations. Remember that we had that debate here, too, with our military saying "But look how much more this is going to cost," to have an all-volunteer force, and, indeed, it did. It is cheaper to draft people and pay them what you want to pay them instead of having to compete.

But to me, this is significant in the wider context of the debate that is occurring on the size of the U.S.S.R. military establishment.

John Hardt and I have a paper coming out later this week, called "Indicators of Change in Soviet Security Policies." He adds a P.S. based on his recent trip to the Soviet Union which was during the election campaign, and how astounding it was to find that Boris Yeltsin, the so-called people's candidate, was advocating a 40-percent cut in the Soviet military, compared to Mr. Gorbachev's comparatively miserly 15 percent.

So, if you have this kind of debate going on in public for the first time in I think any of our memories about not only the question of conscription, but also the size of the military establishment and the size of its budget and the economic resources it consumes, and the tradeoff between military power and restructuring, then, to me, this signals a really significant new ballgame.

That is why I was at such pains to point out that even though one is very much encouraged by this, we do have to look at the alternative outcomes of the Soviet experiment.

Dr. PILON. I wonder if it is fair, really, to always mention West Germany in such glorious terms, or seemingly glorious terms, as to make reference to its policies toward the Soviet Union and, in many cases, actually implying that it is the only Western European country that has a policy, so to speak.

Is that really an accurate way to describe what is happening in West Germany, given, for instance, the lack of genuine concern for the chemical warfare equipment sale to Libya, for instance, and generally its look-the-other-way attitude toward selling almost anything to almost anybody, that is currently going on?

I wonder if perhaps Dr. Stent could comment on how do the other European countries look at this situation. How has the Libyan incident affected their assessment of how West Germany is approaching trade in general and East-West trade in particular?

Is it not a cynical attitude on the part of the West Germans, a "well, let's make a buck while it's hot," kind of thing?

Dr. STENT. Well, the first question, do the West Germans have a policy, it depends on how you define "policy." This, fortunately, is not an academic gathering, so we don't have to go into that.

The West Germans have the most active interest in Western Europe and the Soviet Union, the most active interest of any West European country. This is partly because there are ethnic Germans living in the Soviet Union and in a number of East European countries; partly because Germany is divided; and partly because the Soviet Union, to a large extent, does, in fact, control the extent to

which the two Germanys can talk to each other and the extent to which you have emigration of ethnic Germans.

And so, they have an interest in Eastern Europe and the Soviet Union that is totally different from that of, say, France, Britain, or Italy.

In this sense, I would argue that they have a more active policy because they are trying to do something about it, and these are issues on which the French, the British, and the Italians can do nothing, nor are they particularly interested.

How do they view West German's policy on the Libyan incident vis-a-vis East-West trade? All I can say is, irrespective of what the French say about the Soviet Union, and Mitterand and others sound more skeptical; but, in fact, what they would like to do is to get a larger share of the pie. I mean, they are, first of all, skeptical, or they are concerned that the Germans will have a monopoly on these relations. So are the British.

The French and British would like to have more trade with the Soviet Union. Their economic relationship with the Soviet Union is not that good. They have had for some time a substantial trade deficit. They envy the Germans. They would like to get some of those contracts.

They may be skeptical about what the West Germans have done vis-a-vis Libya. They have been somewhat muted in their criticism. But I would argue that if you look at Western Europe, it is really a scramble to see who can develop the tightest economic relationship with the Soviet Union, and the West Germans are leaving the other EC members, at least, behind.

PANEL III.—ISSUES ON UNITED STATES-SOVIET COMMERCIAL RELATIONS

Dr. HARDT. This morning we covered the subjects of the bilateral relationships and the Alliance issues that affect the consideration of commercial issues in United States-Soviet relations. This afternoon we would like to go to the specific commercial issues, dealing with exports, imports, credits, and joint ventures. We would like to end the session with a discussion of alternative outcomes, with a reference to the likely congressional calendar.

We are always faced with the problem here, in the Congress, in particular, of living in the future by trying to understand the past. I would like Bill Cooper to provide some insights as we approach the commercial issues, as to where we are and where are going, from looking at where we have been.

Bill Cooper is in the Economics Division of the Congressional Research Service, and was formerly at the Department of Commerce.

Mr. COOPER. I thought it would be helpful, as we begin this panel discussion on United States-Soviet commercial relations, to take a look at United States-Soviet commercial relations from a historical perspective, specifically the period of 1972–75, because it was during this period that the framework for operating United States-Soviet commercial relations was established, and also because the conditions under which normalized trade relations between the two countries were defined.

Specifically, I want to take a look at three issues which have been discussed this morning a little bit, and are likely to be discussed in the future, those three issues being most-favored-nation status, or MFN, the Lend Lease debt of the Soviet Union to the United States, and the issue of official export credits.

Most-favored-nation status, or nondiscriminatory trade treatment, lies at the basis of any normal trading relationship among most countries. However, the United States has not extended MFN treatment to the Soviet Union since the early 1950's.

The denial of MFN has been both an economic constraint, as well as a political constraint, for the Soviet Union.

It has been an economic constraint because Soviet imports into the United States are obviously taxed higher than the imports from other countries into the United States. To what degree this is an economic constraint is a point of debate.

It has been a political constraint for the Soviet Union because Soviet leaders have considered it an affront to them that the United States, in not granting MFN, is denying it the status it believes it is due as a major economic power.

Now, mutual MFN treatment was part of the United States-Soviet Trade Agreement that was negotiated in October 1972, to normalize trade relations. However, the Trade Act of 1974, which was approved in January 1975, included the Jackson-Vanik amendment.

This provision was passed in response to the restrictive emigration policies of the Soviet Union and other Communist countries.

It denies most-favored-nation treatment to the Soviet Union and other countries because of their emigration policies, and it requires a Presidential waiver if MFN is to be extended.

In addition, it also denies access to official credit facilities to the Soviet Union and other Communist countries.

Presently, only two countries—Hungary and the People's Republic of China—have been granted such a waiver.

The issue of MFN touches on a second issue, that of the Lend Lease debt of the Soviet Union to the United States. Back in 1972 and the early 1970's, the United States made the settlement of the Lend Lease debt a condition for normalizing trade relations. The two countries did reach agreement on conditions under which the Soviet Union would pay $722 million in order to settle its debt.

The Soviets, under the agreement, made three initial payments, and the other 28 installments were to be made over a period lasting until July 2001. However, the Soviets conditioned the remaining payments on their receiving most-favored-nation status, and, when they did not receive that status, the payments ceased.

The third issue, official export credits, is also a very important one.

The United States does not grant access to the Export-Import Bank or other official credit facilities to the Soviet Union. As with most-favored-nation status, its denial has been an economic constraint.

The economic constraint is that the official credits and guarantees would help to finance United States exports to the Soviet Union, especially during a period that the Soviet Union has been strapped over its hard currency restraints. Some observers also be-

lieve that the official United States credits would help United States firms to meet the competition that has come up from Western Europe and the Asian countries in exporting to the Soviet Union.

The Jackson-Vanik amendment, as I mentioned, has denied the Soviet Union official credits for its restrictive emigration policies. Even if Jackson-Vanik were waived, other ceilings or restrictions are involved.

The Stevenson amendment to the Export-Import Bank Act, which passed in 1975, placed a ceiling of $300 million on new credits to the Soviet Union. The Byrd amendment to the Trade Act of 1974 placed the same ceiling on new credits, not only from the Export-Import Bank, but from other U.S. credit facilities, except the CCC.

In sum, these three issues, most-favored-nation status, Lend Lease debt, and official export credits, are likely to come up if discussions on United States-Soviet commercial relations reach the point of talking about normalized trading relationships. In a sense, the history that we have gone through has established some of the conditions and, possibly, have been precedents for those discussions.

Dr. HARDT. We would like to address the question of the current perspectives of Soviet and United States bilateral commercial relations, and we had invited Prof. Gary Bertsch, along with Steve Elliott, to make a presentation. Professor Bertsch has not been able to join us, but, fortunately, Steven Elliott is here, and he will present the thoughts from their joint paper.

Mr. ELLIOTT. I might just begin by telling you a little bit about the Center for East-West Trade Policy at the University of Georgia.

The center is the only institution in the United States that is exclusively devoted to research and education on Western policy regarding economic relations with the socialist countries of the East.

One of the ways in which we seek to promote research and increase understanding of East-West trade policy is by bringing together experts and interested parties from the Government, from academia, and from the private sector, for conferences and workshops. These frequently result in publications.

I am here today to tell you about a workshop that we held at the University of Georgia just last week. This was the 12th International Workshop on East-West Economic Interaction that brought together 40 of the world's leading experts from the Soviet Union, East and West Europe, and the United States, to discuss the latest developments in East-West economic relations.

In fact, some of the people here today—namely, John Hardt and Dan Bond—were at the workshop in Athens, GA.

Most of you should have before you a written report on the workshop. This report contains a summary of some of the workshop sessions and a number of extracts from papers presented at the workshop, which are especially relevant to today's discussion. It also includes a list of workshop participants and a copy of the program.

Gary Bertsch and I decided that in the time we had available this was the best way to give you a flavor of the workshop and to provide us with some discussion points this afternoon.

The extracts from the papers of Oleg Bogomolov and Nikolai Shmelyov may be of particular use in providing some insights into current Soviet thinking on East-West trade issues.

I would like to make a few very brief and general points about the workshop and what came out of it. I think perhaps John and Dan Bond would agree that the discussions of the workshop were notable for their candor and vigor. This was partly because the participants were speaking as individuals, and not as representatives of their respective governments, and also the discussions were of a private nature. They were not open to the public or the press.

There were agreements and disagreements. Most importantly, there was a strong agreement that the economic and political changes taking place in the Soviet Union today are real, dramatic, and largely irreversible. They present us with a unique opportunity to influence the course of East-West relations.

But they also present us, as we have discovered this morning, with some very difficult choices to make.

As far as disagreements at the workshop were concerned, there were predictable differences of opinion among some American and non-American participants on the appropriate United States response to the changes taking place in the Soviet Union.

Many non-American participants expressed some impatience with the continuation of the wait-and-see approach in the United States. Some felt that the Soviet Union has made important strides toward economic and political liberalization, and that the time is right for America to make some constructive response.

For the Soviets, this would entail, not surprisingly, less restrictive export controls, lifting or waiving the Jackson-Vanik amendment, facilitating or at least not opposing Soviet involvement in the GATT, the IMF, and the World Bank, and generally normalizing United States-Soviet trade relations.

It was apparent that a strong perception still exists among the Soviets that the United States is dominated by old or what they consider to be cold war-type thinking.

There were also some obvious and noteworthy differences among the four Soviet participants at the workshop on issues such as Western credits. Some thought that additional Western credit was absolutely essential to renew the Soviet Union's outdated capital stock, and, therefore, increase productivity. Others were wary that additional credit might prove too burdensome in the long term.

This reflects just part of the debate taking place in the Soviet Union on future foreign economic policy strategy.

Finally, one of the biggest disagreements that came out of the papers and to some extent the discussion, and one that seems to me to be central to the problems we face as we tackle these issues, concerns the relationship between economics and politics. I know that John Hardt has given this considerable thought.

Generally speaking, the Soviets and other Europeans, with the exception of West Germany, believe that East-West trade should be depoliticized or normalized as much as is possible; that is, that trade should stand on its own merits, and should not be subordinated to political considerations.

By contrast, many American thinkers and policymakers believe that trade and other forms of East-West economic interactions,

such as loans, should be used as a lever to force political concessions from the Soviet Union.

My own opinion is that while the political changes that the United States would like to see in the Soviet Union certainly are desirable, one has to consider whether they are best pursued by continuation of the present United States policies or by more economically liberal policies designed to encourage the present trends that we see in the Soviet Union.

Looking beyond the goal of political change in the Soviet Union, one has to consider which policies, which approaches to East-West trade are in the long-term national interest of the United States. In doing this, American policymakers should be more sensitive to the important economic changes taking place in the world today and how they affect the United States.

Dr. HARDT. I would like to turn now to the subject of export controls and would ask Glennon Harrison, who is the specialist in our Congressional Research Service Economics Division on this subject to speak to you.

Before Glennon begins, I want to note that after these formal presentations, we will begin the discussion session. I would like particularly to invite Steve Merrill of the National Academy of Sciences, who was a participant in the major study with which most of you are familiar, on balancing security and commerce, and for which the Congress in the Trade Act, has been mandated to do another study. He can give us some sense as to where export controls will be going from the perspective of the National Academy study.

Dr. HARRISON. Export controls pose a dilemma for the United States at home and with allies abroad. While nearly everyone agrees that such controls are necessary, there are major disagreements over the level of controls necessary to achieve the desired result.

In the Congress, this debate has been a recurring one for many years. The 101st Congress is likely to debate some changes in export control policy during the reauthorization of the Export Administration Act next year. These include issues such as streamlining the control list, dispute resolution, financial export controls, and a number of multilateral export control issues.

Changes in Soviet policy and in United States-Soviet relations are likely to lead to debate over the direction of United States export control policy as well. The question is whether changes in the U.S.S.R. are significant enough to warrant expanded relations, or, if not, what policy changes might be appropriate. For export controls, a decision on where that balance lies must be made for each of the following issues.

In terms of streamlining the control list, critics of current export control policy argue that the Government tries to control too much. They argue that the control list should be updated with greater frequency, that the list should be reduced, and that, if the Government focused on truly critical technologies, U.S. national security and economic goals could be furthered more effectively.

This issue has been taken up by some exporters in the United States and in other COCOM countries under the banner of "higher fences/fewer goods."

Proponents of more restrictive policies argue that older, less sensitive, goods can still aid Soviet military efforts. In the past, efforts to reduce the list have failed. The 1988 Trade Act directs the National Academy of Sciences to identify those goods and technologies which are likely to make crucial differences in the military capabilities of controlled countries and to develop criteria by which to define those goods and technologies.

In terms of dispute resolution, several agencies, including Commerce, Defense, and State, have overlapping and shared jurisdictions for export control policy. However, jurisdictional disputes over which technologies are strategic and the conditions under which high-technology goods should be exported continue to generate complaints from exporters.

Some critics of existing policy, and when it comes to dispute resolution, this would appear to include Under Secretary of Commerce Freedenberg, have argued that the existing dispute resolution process needs to have tighter guidelines and time limitations. It is even possible that exporters might prefer to receive a definite "No" answer than to receive no answer at all.

As an aside, this question might be raised: If agencies within U.S. Government cannot agree on policy, how can a multilateral organization, such as COCOM, achieve the degree of consensus necessary to operate smoothly and fairly? Is it likely that a consensus can be achieved without the sorts of disputes that characterize the U.S. export control process?

Let me address financial export controls. Legislation has been introduced the authorize the President to monitor or restrict private lending, especially untied lending to the Soviet Union.

Proponents of this approach argue that controls on financial flows are a logical and necessary complement to controls on goods and technologies. Opponents maintain that such controls are unnecessary, and are unlikely to be effective without cooperation from other Western governments, which many believe to be unlikely.

This brings me to multilateral issues, of which I will mention only three.

First, U.S. businesses and other COCOM nations are pressuring the U.S. Government to end the no-exceptions policy. Under that policy, which was adopted by the United States after the Soviet invasion of Afghanistan, the United States votes in COCOM to deny all export license applications that involve strategically sensitive high-technology goods. In 1985, the no-exceptions policy was incorporated into the Export Administration Act of 1979.

Because COCOM operates by consensus, the U.S. vote to deny amounts to an effective veto. During the last 9 years, no approval of exception-level goods have been granted.

With the Soviet withdrawal from Afghanistan, proposals to drop the policy have been advocated in the United States and by other COCOM countries. Factors favoring reconsideration include the withdrawal, other possibly favorable changes in United States-Soviet relations, the possible damage to the cohesiveness of COCOM should the policy not be revised, and that the policy is based primarily on foreign policy, rather than strategic considerations.

Proponents for maintaining the no-exceptions policy, however, noted that trade in strategic goods has never amounted to more than 2 percent of total trade, that elimination of the policy will not be a trade liberalizing measure, and that the policy should only be changed after the full national security implications are considered.

Whether the current policy is continued or not, the United States will still be able to effectively veto any applications that it considers threatening to international security.

This brings me to the second multilateral concern:

Other COCOM members have been critical of the way in which COCOM operates. A recent British parliamentary study asked for immediate and radical changes to COCOM procedures.

Chief among these is a shifting of the burden of proof from export license applicants to the parties seeking to deny the license. Although somewhat unclear, such a change might affect the veto power that each COCOM member currently enjoys.

Last, I want to mention the European Community's plan for economic integration by 1992.

Assuming that the export control procedures of the EC are upgraded and found to be acceptable to the United States, as individual countries, this should lead to the realization of one of the objectives of the Trade Act of 1988, a license-free zone that covers all COCOM countries.

Dr. HARDT. One of the issues that is certainly going to be very much evident in these halls in the near term, as it has been in recent times, is credit.

We are delighted that a group could come from the Export-Import Bank, which has sometimes, I understand, been referred to as a secret weapon of the U.S. Government, or at least a secret.

We will have a presentation starting with Daniel Bond, and proceeding, I believe, with Mr. Thomas Moran.

Dr. BOND. The Eximbank is certainly pleased to be involved in this meeting. John Hardt has already introduced Mr. Tom Moran, who is our Vice President for Europe and Canada. He knows the operational side of the bank and what we might be able to do if we were open to the Soviet Union, and will speak on that.

Mr. Stephen Glazer, our Associate General Counsel, has been involved in the legal issues surrounding United States-Soviet financial relations since the early 1970's.

I would also like to point out that Mr. Frank Record, our Congressional Relations officer is here, and Dr. Rita Rodriguez, from our Board of Directors, is also joining us today.

So, you can see that we have a keen interest in this discussion.

Since you have the paper, I will not go through it in detail, but would like briefly to deal with the first three questions that the Congressional Research Service asked us to answer, and then will let Tom answer the last two questions.

First, the CRS would like to know about Eximbank's past relations with the Soviet Union. I think most of you have a general knowledge of those relations, particularly what happened in the early 1970's.

I would like to point out that when the bank was first set up by President Roosevelt in 1934, its purpose was to facilitate trade with

the Soviet Union, during a period when relations were beginning to improve at that time. The Soviet Union had just been recognized by the United States Government in 1933. A few months later, the Eximbank opened its doors.

However, we actually made no loans at that point because, immediately, one of the many contentious issues that we would face over the next 55 years arose, and this was the lack of settlement on the Kerensky debt. The Provisional Government of Russia before the revolution had borrowed from the United States Government to help finance its participation in World War I. Lenin refused to pay on the loan and the issue of repayment was still unsettled in 1934 and Eximbank made no loans at that time.

At the end of World War II, the United States was once again on more friendly terms with the Soviets. There was a general perception that the United States would assist the Soviet Union in rebuilding their economy. Eximbank was prepared to finance United States exports to the Soviet Union to help with the reconstruction effort.

Once again, issues arose which stopped that.

At this time, it was the Lend Lease loans that the source of disagreement. In addition, the fact that the Soviet Union refused to release information on their reserves, their gold reserves, their hard currency reserves—on almost any financial information—which the board of the Eximbank felt was essential before they made any loans to the Soviet Union. So, Eximbank did no business at that time.

Soon thereafter, the cold war began, and, over the next 30 years, there was a continual series of prohibitions on the Eximbank financing trade to the Soviet Union.

However, as you know, in 1973–74, the bank did go into business with the Soviet Union in the sense that we financed the export of about $1 billion of United States equipment to the Soviet Union, by providing 469 million dollars' worth of financing to the Soviets.

The Soviets are still making payments to Eximbank on that debt. They have an impeccable repayment record. The final payment will occur in 1990. They still have $72.3 million in obligations to the bank.

Tom Moran did a very interesting calculation, that the bank has received $284 million in fees and interest, on the initial $469 million in lending that we did back in the 1973–74 period.

The second question the Congressional Research Service asked was what are the specific legislative restrictions concerning Eximbank lending to the Soviet Union.

You have already had a rundown on this from Dr. Cooper. He has pointed out the most relevant laws. What I would like to do is just clarify a couple of points.

We are often asked what is it really that keeps us from lending to the Soviets today. The easy answer to that is Jackson-Vanik amendment to the Trade Act of 1974, in that if there were a waiver or a lifting of the Jackson-Vanik restrictions, then probably the bank could start considering having relationships with the Soviet Union once again.

The Stevenson amendment and the Byrd amendment are quite similar in that they would not have a limiting impact on our lend-

ing at first. Both of these, the Stevenson amendment to the Eximbank Act of 1945, and the Byrd amendment to the Trade Act of 1974, set a $300 million limit on new exposure to the Soviet Union.

Eximbank currently has $75 million remaining in exposure to the U.S.S.R. But the Stevenson and Byrd amendments' $300 million limitation refers to new loans, loan guarantees, or insurance. So, any type of new exposure to the Soviet Union, not just loans, but also guarantees, would be counted.

Would that be a great problem? Well, we would see what level of applications the bank would get and how rapidly we would build up an exposure to the Soviet Union. But, certainly, neither the Stevenson nor the Byrd amendments are an immediate problem.

So, it the easy answer is Jackson-Vanik, in terms of what is keeping us from doing business right now.

There are many details. As I mentioned, we have had other disagreements with the Soviets in the past about settling the Kerensky debt, the Lend Lease debt, the provision of information. There is other relevant legislation. But it is quite possible that none of these would present a real barrier to starting to finance United States exports to the Soviet Union once Jackson-Vanik was waived or lifted.

Now, I have gone over those two questions very quickly because I wanted to get to what I think is the most important new information for our discussion this afternoon, since other people have covered these other issues in greater detail, and that is the change in relationship between the Western export credit agencies and the Soviet Union that has occurred since the early 1970's.

I think a lot of our perceptions about what kind of relationship we would have now has been based upon memories of what happened in the early 1970's. However, a lot has changed since then.

The United States has actually been quite opposed to official subsidization of trade through financing since the early 1960's. Our Western allies, most of whom have export credit agencies similar to the Eximbank have had quite a different view on this and have persisted in their use of official credits and guarantees to facilitate their exports. The United States has responded by placing pressure on them for some time for rules to prevent excessive competition and to actually make it better for all of us in this process.

Where this affects the Soviet Union is that in the mid-1970's, most of the export credit agencies agreed to an arrangement, the "OCED consensus arrangement," that defines specific rules on the terms and the interest rates of lending to various categories of countries.

All countries were divided by GNP per capita into the categories of rich countries, not so rich countries, and poor countries, and different rates and terms were set according to this arrangement for each of these categories.

Since the mid-1970's, these rules have been tightened and improved in various ways. The major direction of the improvement has been to try to reduce the subsidization and, finally, to eliminate the subsidization on medium- and long-term credits and guarantees to the rich countries.

Now, it has taken about 10 years or more of negotiations to succeed in that. In our paper there is one figure on page 9 where you

will see a graphical presentation of what has occurred in this period of negotiation.

The dotted line is an attempt to show what commercial lending rates to a country like the Soviet Union would have been from 1978–88. This is based upon market rates for medium-term credits. The solid line shows what the OECD consensus rate; that is, the rate that the export credit agencies have agreed to abide to in lending to the Soviet Union.

The story that this graph tells is that in the 1970's there was a significant degree of direct subsidization; that is, the interest rates on loans that were going to the Soviet Union were well below market rates, up to 8 percentage points at times. But there were changes that were implemented in the 1980's that today have brought those two lines very close together. In fact, one of the interesting little quirks here is that the market rate dipped below the consensus rate during a period in the mid-1980's.

Now, one piece of evidence that this is not just purely theoretical is the Soviets shifted a lot of their borrowing away from the export credit agencies and to syndicated commercial loans during that period. They were very sensitive to these interest rate differentials.

Today, the reason why those two lines will stay together is that the Soviet Union is classified as a rich country, and by agreement Eximbank and the export credit agencies of most other countries do not subsidize credits to rich countries. Interest rates are set for each major currency every month in accordance with the market rate. So, there is no opportunity for lags to occur between changes in market rates and changes in the consensus rate, which was a problem for a period of years.

So, the major change that has occurred in terms of the question of would we be subsidizing the Soviets if we were involved in providing financing for United States exports to the Soviet Union is that the direct subsidy has been pretty much wrung out of the system by the OECD consensus arrangement.

There is a monitoring system in place to make sure that the members adhere to these agreements, and all evidence, in the case of the Soviet Union, points to the fact that there has been strict adherence to the agreement.

Now, I would like to give Moran the opportunity to briefly discuss the remaining two issues; that is, what kind of activities we are currently seeing among the other export credit agencies and what type of policies does the Eximbank have for financing United States exports to category I countries—in other words, what kind of policies would we have in financing United States exports to the Soviet Union if we did have a waiver on Jackson-Vanik.

Mr. MORAN. Except for the United States, all of the major Western governments provide export financing to support the efforts of their countries' exporters to sell their goods and services to the Soviet Union.

To be a bit more specific, what I mean is that there are government agencies—we refer to them as official agencies—in all of these countries which support their exporters.

While our focus here today is on the Soviet Union, it might be interesting to note that most, if not all, of these official agencies provide the same kind of support to such countries as East Germa-

ny, Czechoslovakia, and Bulgaria. As I will note in a minute, we get a number of inquiries from American exporters not only about the Soviet Union, but about those countries as well.

The nominal dollar value of the total commitments, either in the form of loans or guarantees, of the official government agencies of these countries reached a peak in 1982, when it hit a figure approximating $22 billion. At that time, West Germany had the highest level of commitments, followed by Japan, France, Italy, and the U.K.

Since 1982, the value of these commitments has been in decline, and around September of last year, it had dropped off to about $16 billion.

Japan's share in this total has been rising, and, although the nominal value of its commitments is slightly less than in 1982, Japan now has the highest amount, with West Germany being in the second place.

In 1983, the Soviet Union began to shift its borrowings from official sources; that is, government agencies, to what we call syndicated credits and international bond issues. That is, the pattern in their borrowing began to shift from borrowing from official sources to groups of private commercial banks.

The trend away from official export credits reflects the relative competitiveness of the commercial banks as lenders at a time when consensus rates were on the rise; that is, the rates offered by the official export credit agencies.

Official export credits to the Soviet Union we think are likely to increase again in the future for a variety of reasons. The OECD has noted that, with rising unguaranteed exposure, as a result of Soviet pressures to resist guaranteed credits when cheaper finance was available in the private markets, the willingness of banks to allow their exposure in the Soviet Union to rise without adequate compensation has tapered off.

In other words, the Soviets will need to turn to a greater degree to official sources or pay rather higher rates if they continue to borrow from private sources.

A number of countries are eager to take advantage of Soviet economic reforms through greater efforts to increase their export sales to the Soviet Union.

Last year, a number of West European export credit agencies negotiated what are referred to as "framework agreements" for substantial trade credits to the Soviet Union. So, we think that the downward trend in activity seen since 1984 has bottomed out, and may well turn around this year.

Like most of the other export credit agencies of the world, Export-Import Bank is a member of an organization referred to as the Berne Union. Through our membership in that organization, we have occasion to be aware of what the other export credit agencies are doing in the Soviet Union.

All of these export credit agencies exchange telex messages and other forms of correspondence as well, concerning country creditworthiness and concerning the terms and conditions of financing for specific projects they either have made or have under consideration for exports to the Soviet Union.

I won't be theatrical about this, but I have here a pile of these telexes, which I have collected over the past 6 or 8 months, as we began hearing more and more about the Soviet Union. As I mentioned earlier, some of them relate to East Germany or Czechoslovakia. But I would say that 98 percent of them are about projects in the Soviet Union.

They refer to all kinds of projects, from plants to make breakfast cereals, shoes, hotel and dairy projects, exports of rubbish incinerators for the city of Moscow, and that sort of thing. It is not possible to tell exactly how much is involved in terms of dollars or other currencies because the figures mentioned as to the costs of these projects are in different categories, which only bracket the numbers. But it is easy to see that in total, these projects amount to several billions of dollars. Some of the projects by themselves are valued at several hundred million dollars.

The final question, I guess, that we wanted to focus on was some idea of the possible future impact on United States trade of removing the restrictions on Eximbank financing of exports to the Soviet Union.

We have not made any effort to quantify any projections of such increases that would result if the restrictions on Eximbank were lifted.

The demand for financing would depend, in large part, on the kinds of assistance made available and what terms were offered.

As Dan noted earlier, the Soviet Union is, under the OECD country classification system, what is known as a category I, or "rich" country, and that defines what Eximbank programs could be offered there if we were to be open. Those programs would include export credit insurance, which is provided through an organization known as the Foreign Credit Insurance Association. It would also include Eximbank working capital guarantees, which actually provide an American exporter with working capital while he puts together an export transaction. Eximbank's guarantee program, which provides guarantee cover for private sector lenders lending to a foreign buyer or borrower, and possibly Eximbank direct loans at CIRR, which means commercial interest reference rates, to a buyer or borrower in the Soviet Union. That would be done, however, only in cases where we were convinced that there was foreign competition offering subsidized official—that is, government—export credits.

This final form of support; that is, direct credits, may be in some sense a moot point now because of the drastic limitations on our direct credit budget.

Based on the bank's evaluation of a country's creditworthiness, there is another factor that ought to be mentioned, and that is Eximbank's exposure fee. That is a system of fees which we charge, and the fee is a percent of the bank's exposure in any transaction. The amount of that fee depends upon the category of the country.

I might note that it is our own country categorization system, as distinct from the OECD system. It is a function of the term of the credit and the type of borrower.

When evaluating the creditworthiness of the Soviet Union, we probably would, once again, have to discuss with the Soviet au-

thorities our need for improved or increased disclosure of data concerning the Soviet Union's economic and financial condition.

While the Soviet Government has begun to be more open about certain aspects of their economy, they still do not provide the kind of information Eximbank ordinarily requires concerning convertible currency trade, foreign assets and liabilities, or various types of reserves.

While an assessment of Soviet creditworthiness—and this would be Mr. Bond's headache, since he is the new head of our Country Risk Analysis Division—can be made on the basis of various Western estimates, the uncertainty inherent in this approach would increase the perception of risk and result in our charging the Soviets a higher exposure fee than might be warranted if we knew more about their economic and financial condition.

Dr. HARDT. We are very much interested in the credit policy. One of the participants who we had hoped would be here, Judy Shelton, is very much concerned with, as many of you know who are familiar with her book, the context of the building up of domestic monetary overhang and the substantial need for credits perceived on the part of the Soviet Union and the potentiality for availability of credits that would not be restricted in their use.

Various others have made assessments of Western lending to the Soviet Union. One paper that you have in front of you is prepared by Richard Johnson of the Office of Soviet Affairs at the Department of State.

Mr. JOHNSON. The patient reader who goes through my paper will get this in more detail. I will try to summarize briefly the points that I have made.

When John Hardt invited me to this workshop, I thought it would be useful to submit a paper on Western lending to the Soviet Union, because there has been a wide gap between perceptions and reality.

My paper, which is based largely on CIA data, is aimed at clarifying what has been going on for the past few years.

The widespread perception is that Western lending to the Soviet Union has surged, that the West is providing a big chunk of extra resources to Gorbachev, and that if we could restrict so-called untied lending to the Soviet Union, we could control how the Soviet use hard currency.

These perceptions are understandable in the sense that the gross stock of Soviet hard currency debt has, in fact, almost doubled since 1984 in dollar terms, and I underline "in dollar terms."

These perceptions are also understandable in the sense that the Soviets are clearly determined to modernize their industry and improve living standards, and it seems natural to assume that they would turn to the West for credits for that.

Finally, it seems intuitively reasonable to think that if we attach strings to credits to determine how they are used, that will give us control.

These widespread perceptions have led to lots of editorials for and against the idea of helping Gorbachev's reform. But the real story is very different and much less dramatic.

My paper tries to make four main points. The first is that Western lending to the Soviet Union has remained modest over the past

few years. The second is that, in fact, between 1984 and 1987, the Soviets actually paid back more to the West than they borrowed.

Third, in those years when the net flow of lending has been positive for the Soviet Union, it has been very small, compared to Soviet hard currency earnings or the overall resources available to the Soviet economy.

Fourth, I argue that the idea of restricting untied loans would not, in fact, give the West control over Soviet hard currency spending.

Let me run through these points as succinctly as I can here. They are explained more fully in my paper.

First of all, the stock of Soviet debt has, indeed, almost doubled since 1984. But it has gone up so sharply because of a depreciating dollar, and not because of a surge in new lending.

The Soviets borrow more than one-half of their borrowings in nondollar currencies. When those nondollar currencies go up against the dollar, the stock of Soviet debt goes up. This valuation effect has accounted for about three-quarters of the increase in Soviet debt from the end of 1984 to the end of 1987.

This valuation effect also makes Soviet debt stocks and the changes in them, a very poor measure of what is going on in terms of borrowing.

The second point I make in my paper is that the best way to gauge how much extra hard currency the Soviets get from borrowing from year to year is to look at something called the "net transfer measure," which is annual borrowing minus repayments on previous borrowing.

In 1984, 1985, and 1986, this net transfer measure was positive. But it gave the Soviets only about $300 million per year in extra spending power.

In 1987, on the other hand, the net transfer measure was negative. The Soviets repaid $4.6 billion more than they borrowed.

If you take the 4-year period overall, from the beginning of 1984 through 1987, the net transfer measure was also negative. Over that 4-year period, the process of borrowing and repaying money by the Soviets actually produced a net flow of hard currency of $3.7 billion from the Soviet Union and toward the West.

This net transfer measure is a reminder that it costs money to borrow money. The Soviets borrow principal, but they pay back principal and interest.

This means that if the Soviets do not use the money they borrow for some constructive purpose that has a higher rate of return than the interest they pay on that lending, they end up with less spending power in the long run.

The third point I make in my paper is when the net transfer measure has been positive, that $300 million per year in 1984, 1985, and 1986, it has been very small compared, for example, to the average $33 billion a year that the Soviets earn, as opposed to borrow.

That net transfer measure is also very small in the context of the overall Soviet economy, where GNP is on the scale of $2.5 trillion.

To illustrate how small this net transfer measure is, you can do some sorts of hypothetical scenarios.

If you say, for example, that the Soviets borrowed enough new money to multiply that net transfer measure by a factor of 10, so they would have an extra $3 billion a year to spend on imports; and say they spent that extra $3 billion to import consumer goods completely.

This could raise Soviet consumption by about 0.3 percent, or an extra 30 cents for every $100 consumed.

Alternatively, if they used an extra $300 billion a year to import capital goods, this would add less than 1 percent to their total domestic investment.

What these scenarios underline is how large and also how closed and autarchic the Soviet economy still is.

If you move back from the scenarios to the real world, it is worth noting that the Soviet economy has become more self-reliant under Gorbachev, rather than less. From 1985 through 1987, Soviet imports of both consumer goods and capital goods were down and not up.

The fourth and final point relates to the distinction between tied and untied lending.

I argue in my paper that when you take a close look at this issue, even aside from the question of whether or not it were feasible from an Alliance point of view to do this, the idea of controlling Soviet use of hard currency by restricting untied lending is, in fact, an illusion.

The Soviets have access to over $30 billion a year in hard currency from export earnings. Those earnings are untied cash. Most of those hard currency earnings go to pay for imports and to service debt. But because money is fungible, or interchangeable between uses, any increment to those hard currency earnings that the Soviets obtain by borrowing, whether tied or untied, could free up hard currency earnings for other uses.

I think that wraps up my summary.

PANEL IV.—ALTERNATIVE OUTCOMES AND THE CONGRESSIONAL CALENDAR

Dr. HARDT. I would like to proceed to the discussion of the alternative outcomes, which will provide a framework for us all to join in and discuss the pros and cons of the policy of commercial facilitation or commercial restriction.

I have not had a specific discussion prior to this on joint ventures, as indicated in the handout, but we will take up the subject during this session on alternative scenarios of joint ventures.

I would note in this regard, in some recent discussions with Germans, the question of development of joint ventures and credit led to a realization that the announcements of the Soviet credit lines of the German banks related to the visits of Chancellor Kohl, are credit lines that have not yet been drawn on. One of the major reservations in the discussions of the joint venture contracts related to those developments has to do with assurances—assurances, for example, on guaranteeing of investment and return on equity; assurances that there would be an appropriate and useful exchange rate negotiated in the specific contracts; protection of interests in patents and licenses; and a variety of other issues involving manage-

ment and infrastructure, informational questions that are crucial and have not yet been resolved.

So, in our later discussion, we may wish to deal with some of those issues as they apply to U.S. joint ventures as a prospective development, including possible discussion of the American Trade Consortium, which was an interesting development in the recent past.

So, to provide a framework of how to approach the subject, I would ask initially Sarah Carey, followed by Sumner Benson and Juliana Pilon, with a final commentary by John Mroz to set the stage for a discussion which will include all of the issues we have discussed to date—the bilateral issues, the Alliance issues, and the specific issues on commercial relations.

At some point, I would also invite Ed Hewitt to make some comments specifically on how important commercial relations might be to the success of "perestroika," a subject on which he has been in print recently, and for which I think he can add to our discussions and deliberations.

Ms. CAREY. I would like to make two observations on the agenda handout. One is that the name of my law firm is Heron, Burchette, Ruckert & Rothwell. It may sound petty to try to straighten out the names, but their ordering reflects considerable negotiation among partners.

Second, on the "alternative outcomes" topic, I am assuming, without having been told, that I am considered one side of the table, since I don't have a very balanced view, and that other people on the panel will provide the balance, presenting the other side. Is that correct, John? I assume I am here for that purpose.

My bias is reflective of that of the United States business community because I am an attorney heavily involved in representing United States companies that are involved in negotiating various transactions in the Soviet Union.

All of the items that have been discussed in lofty and sometimes abstract terms regarding the bilateral economic relationship, parallel problems that all of the companies I represent run into on an everyday basis. They would like to see the United States policy on United States-Soviet trade modified to recognize the Soviet Union as a potentially significant trading partner instead of exclusively as an enemy, a competitor in the political sphere, et cetera.

The threshold question is, Are we as a nation truly going to look at the trade opportunities that could unfold from the gradual opening up of the Soviet economy? All of the policies that bar a normal trade relationship between out two countries have been set out by the CRS staff. They each need to be examined in terms of both the difficulty of their modification and the ability to achieve positive gains by the modifications.

The first, and the most obvious, correction should be the repeal of Jackson-Vanik. I am basically the wrong person to discuss this. This issue, Mr. Frye should be talking about, based on his very excellent article that just appeared in Foreign Affairs, with Adlai Stevenson, which I hope all congressional staff members will at least summarize for their Members, if their Members do not want to read the whole thing.

A Jackson-Vanik waiver would cost nothing. I think if we had any Executive leadership at present on the bilateral relationship, a waiver or repeal would be announced, over with, and finished, having outlived its objectives.

I do not think that there are economic, political, or human rights reasons for holding on to Jackson-Vanik any longer. Its stated purpose, which is only one of many purposes for enacting it, is being responded to not because of the amendment, but because of the internal changes occurring in the Soviet Union anyway, in regard to emigration policy as well as other aspects of civil rights.

Above all, the worst approach that Congress could take would be one of gradualism, sort of a calibration approach, where the Congress sits in judgment of each change occurring in the Soviet Union, weighing whether or not it justifies MFN treatment. This approach, which has already been discussed, will not work. Further, it is offensive, and would only impede the overall relationship, not just the trade relationship.

In short, I would strongly advocate the complete repeal of the Jackson-Vanik approach for many of the reasons that Mr. Frye has set forth in his article. A key point that he has made is that the human rights issues are now being addressed in the Conference on Security and Cooperation in Europe, and significant commitments through that process have been obtained from the Soviets, and that that is the right forum for addressing these issues.

Waiver of Jackson-Vanik would be significant in several respects: It would get rid of part of the U.S. hangup of viewing trade as a privilege that we bestow on those that we favor and deny to those out of favor. It would have tremendous symbolic significance in terms of the Soviets. It is probably more significant symbolically than practically in terms of dollars and cents. And it would also affect some imports. We have clients trying to import manufactured goods from the Soviet Union, and the tariffs can be as high as 125 percent of value. It is just not sensible to even consider those kinds of imports, except in luxury items, which are price insensitive.

So, you are not going to have a sudden flood of goods coming into the United States. You will probably have a gradual increase, and you will probably have the Soviets targeting certain products that they will adapt to the United States market, gearing the design to our consumer fussiness.

But the repeal of Jackson-Vanik will not hurt economically. And it will not hurt in terms of our position as a world champion of human rights. It will instead, be a productive gesture, which will allow an advancement in the economic sphere.

I think the same concept, of not barring individual products for political reasons, such as the old bars on the import of furs and other products should be adopted across the board. But I realize that this difficult given the fact that rightwing Congressmen can easily attach riders to various kinds of bills.

So, my starting point is not a waiver of Jackson-Vanik, but a repeal. This does not minimize the many political problems and tradeoffs that have to be made up here. However, these are sorting themselves out. A number of the Jewish organizations have gone very far in their position on this issue, to a point where I think it

should be taken out of their hands. It is not theirs to decide yes or no, if we shall accord the Soviets most-favored-nation status. It is the Congress' decision, and no single interest group should dictate it.

The debate needs to be reframed nationally. If we get some leadership up here on the issue, people will begin to realize that denial or granting of MFN is not giving any special privileges or advantages. It is basically giving nondiscriminatory treatment.

On the issue of whether financial credits or guarantees should be available to support United States-Soviet trade, the World Bank presentation which we just heard is extremely helpful. Certain kinds of transactions should be part of the normal course of business in the U.S.S.R. as elsewhere. The Congress should ask whether we are trying to punish the Soviets or to advance our own trade position as a nation, recognizing that we have a significant trade deficit and need to generate new exports. In regard to both insurance and guarantees and the other nondirect financial support, trade with the Soviets should not be treated any differently from trade with the PRC.

In regard to export controls, this problem is very difficult to describe in a way that does not make you sound anti-American. The businesses that I deal with all are firmly committed to preserving the U.S. strategic technology, but very concerned about the definition of that technology and the highly discretionary nature of the process by which the controls are administered.

In fact, the process itself is so irregular and unreliable that it creates disrespect for the entire system. This is not in the West-West area that I am talking about; it is strictly in the controlled countries area. It has been particularly acute in regard to joint ventures.

We represent a group of companies that have joint ventures already, or are close to having them, called the Ad Hoc Group on Export Controls. The stories that they have put together about the process make stories of the Soviet bureaucracy pale, and exceed the humor about Gosagroprom, before it was "liquidated."

Despite the fact that President Reagan and Gorbachev, in the Washington summit, took a position in support of joint ventures that were commercially viable and did not involve strategic products, the Defense Department defined its own policy which is, overall, opposed to joint ventures. It has greatly attenuated the process of clearing licenses, for technology transfers particularly, wherever a joint venture is involved.

I would be glad to give anybody who is interested detailed information on this.

The process has gotten so out of hand that in some cases the decision of whether or not to issue a license has been escalated to the Cabinet. This is an absurd waste of personpower, of manpower, in those cases.

Anyone examining the export controls ought to consider several actions. One would be to increase congressional oversight. Very few of the reforms that Congress puts into the trade acts actually get implemented, or they take a long time to get implemented where export controls are concerned.

Despite Congress' very positive thinking on foreign availability; that is, the ability to decontrol items based upon proof that they are available from other countries at the same quantities, qualities, terms, et cetera, only a handful of insignificant products have been decontrolled to date. For example, DOC based on an exhaustive study conducted by the Foreign Availability Section and others, has recommended decontrol of AT computers because of their widespread availability in Asia and elsewhere. Yet no action has been taken on the study because DOD opposes decontrol.

Foreign availability, viewed by the business community, is a farce. It is wonderful language. It generated a lot of heated debate during the renewal of the bill, every time it is renewed, and it will come up again next year, but nothing ever happens in terms of results. That is the frustrating part.

The same criticism applies to statutorily defined deadlines for the processing of license applications. DOC often meets them on West-West licenses, but if you are seeking a technology transfer license involving a joint venture in the Soviet Union, forget the timetables. You basically have to build into your expectations and your commitments to the Soviets timeframes of a year, a year and one-half, or whatever.

These are just examples, but they suggest areas where Congress could act now to reduce the ongoing discrimination against trade with the Soviet Union, in all the areas that were held up as the criteria for change in our policy toward trade, has made tremendous strides forward, either in announced reform, or in change of actual practice. They have redefined policies that move in the direction. The trendline is correct.

There ought to be some significant recognition of these developments.

In regard to export controls, a virtual throwaway concession would be lifting of the remaining Afghanistan sanctions. Besides the no-exeptions rule, there are also the restrictions on Kamaz and Zil, which, as you will recall, just basically barred all trade that might contribute to the construction of trucks.

Now, for the American automotive industry, this is a significant restriction; but not for the rest of the world. It is another small irritant that could be moved fairly easily.

In regard to joint ventures, I am very interested in John Hardt's questions listed on the agenda for this meeting. They are questions that have plagued the American companies as much as the West Germans who raised them, as John just stated.

I think many of those questions are really questions that the Western business partners can hammer out with its Soviet counterparts. I shudder to think of what might happen if the United States Government got involved in that process, other than to alert, through the Bilateral Working Commission, the Soviets to the fact that a large number of companies are concerned about the issues.

From the United States Government's perspective, what is needed is not so much help in thinking through how to get the Soviets to give proper guarantees, instead for the United States to establish a clear policy framework for joint ventures.

Many U.S. companies have been afraid to rely too heavily on the Reagan-Gorbachev position on joint ventures, because they are afraid if they even bring up the subject, there will be a backsliding and a less favorable position will be adopted. This is hardly a way to get involved in a long-term commercial relationship.

Many have commented on the fact that there are very few United States-Soviet joint ventures, compared to Soviet joint ventures with European partners, and that the capitalization of these, all together, remains fairly piddling.

Most companies are very hesitant to take big steps, big swallows. They will build the venture a step at a time, waiting and watching to see what the U.S. Government will do.

For United States-Soviet joint ventures to flourish, we need some sort of confirmation, at the least, of the Gorbachev-Reagan position, or, more hopefully, a stronger, less tenuous, position that will allow the companies to go ahead and plan, not subsidizing them, not giving away anything, but to go ahead and plan their own businesses. I think they are willing to do that.

The Soviet market represents tremendous opportunities in many sectors where the global economy is saturated; continuing to discourage U.S. participation in this market would be a serious mistake.

On the international organizations issue, to me it seems so obvious that I can hardly address it. If the Soviets were to be brought more into normal behavior and be part of the normal economic community, that would be a plus for everybody.

That was a premise that was stated for many years, and now that they are making signs that they want to do it, everybody is sort of scared.

I would suggest that in regard to the question of Soviet participation in international organizations, the same process or a similar process be followed with them as has been followed with China and other nonmarket economies that are difficult to integrate into the world trading system. The conditions that are the underlying premises of the GATT and the other international organizations should, of course, be applied to the Soviets; and there should be a process of helping them understand these conditions.

They are open to it. They want to be educated. It will be years before they can meet all the standards. But I think the process should be begun.

I would like to mention, in closing, that we represent a small group of companies, called the Balanced Trade Group, which is lobbying, in a quiet and targeted fashion—it is so targeted that I am sure some of the staff up here have not even been "hit"—to achieve a better posture for United States-Soviet trade. The issues besides the ones that I have mentioned would include negotiation of an investment protection treaty and renegotiation of the United States-U.S.S.R. Tax Treaty, and probably the investment protection guarantees should be part of an overall bilateral trade agreement.

I think the bilateral relationship needs such an agreement. It would be much easier to waive Jackson-Vanik through the enactment of such an agreement, rather than having to amend the 1974 Trade Act, which, otherwise, is going to be necessary.

For those of you who do oversight over the DOC, it would be nice if you would ask Secretary Mosbacher when he intends to schedule negotiations for such a new treaty. Secretary Brady should also be pushed on the Tax Treaty.

The Bilateral Tax Treaty is up for renewal. It can move independently of amendments to the Trade Act or to Jackson-Vanik. And joint ventures have created a need for a totally different kind of tax treaty.

Basically, our current tax treaty does not contemplate investment by United States companies, in the Soviet Union. So, the ability to invest through joint ventures or through a foreign trade zone or through any other form of investment that the Soviets might permit in the future is not covered by the Tax Treaty. This creates all kinds of difficulties for U.S. companies.

Finally, I would go one step further. It is a small step. I think that those of you who worry about authorizations and appropriations should give the Department of Commerce a little bit more money to focus on United States-Soviet trade. This is an enormous market. Companies going into it need help because it is such a different business culture. The people—it was a person most of the time and now it is "people," two of them—who help United States companies in the Soviet Union on behalf of USCO are extremely capable and make a tremendous difference. Backstopping them a little bit, and giving them typewriters that work and other standard office equipment could make a real difference.

In conclusion, I would say that it is time to add trade to the debate about United States-Soviet relations on its own terms and not as a stepchild to politics. Trade should not be viewed as beneficence or a reward to the Soviets, but as an economic activity that will benefit both sides. We should no longer ask, Is Soviet emigration rising enough to allow trade, or are the Soviets reducing their adventurism in Third World countries sufficiently to allow trade? Instead, we should ask, How can trade be encouraged to benefit the United States economy and to encourage further liberalization of the Soviet economy.

Trade by itself is very important. It is important economically. It is important also as a way of interlinking the United States and Soviet interests in terms of both individual transactions and the international trade community.

In many ways, it can go much further to encourage the kinds of Soviet reforms and the kind of bilateral relationship that I think everybody here wants, than many other kinds of interaction. And instead of costing the U.S. Government money, it generates income for all concerned.

Dr. PILON. The question of alternative outcomes and the Congressional Calendar is of particular significance at a time when Congress is increasingly, sometimes even felicitously, involving itself in East-West trade policy.

The Jackson-Vanik amendment is the obvious, best, example of a congressional measure whose impact on policy has had lasting effects, introducing an element of considerable significance into the debate, the issue of human rights.

Here we are, however, 15 years later, and the question of congressional involvement is with us again. More to the point, the

question itself of the relevance of human rights as an issue in East-West trade policy returns almost with a vengeance, for proponents of increased trade relations between the U.S.S.R. and the West have been using human rights and the ideal of liberalization as a reason for offering trade concessions to the Soviets.

What, then, is to be done?

From the outset, I would suggest that the debate be slightly restructured—I was going to say in the interest of openness, but that seems a bit much.

It seems to me that the proper dichotomy is not between facilitation of trade and the one hand and restriction on the other, as is indicated in the schematic agenda provided for us today. It seems to me that the crucial question before us, before Congress, indeed, before Western policymakers, is, rather, what policies are more likely to encourage democratic change in the U.S.S.R.

There are at least two ways to answer that question. One, emphasizing Western commercial concessions to the Soviet Government, seems to assume that change will come primarily through the decision by Soviet leaders, Gorbachev, in particular, to allow such change in the expectation of continued trade with the West.

Another, implying continued Western skepticism regarding the meaning and sustainability of current changes in the U.S.S.R., would make use of all available means to institutionalize democratic change, whenever possible, encourage further such change, and, above all, continue to protect Western national security—for that is, if I may recall John Locke, the principal function of government.

It is the latter attitude that should, in my opinion, and if I may be optimistic, probably will, guide congressional attitudes toward East-West commercial policy in the future. There are, after all, a number of significant ways for the West to indicate that we in the Free World do have a meaningful and moral policy toward the Soviet Union. We believe in individual liberty, in human rights, in free enterprise, and in national security.

This policy actually translates into some interesting options. One of them would be the continued refusal to waive the Jackson-Vanik amendment. As Senator Dennis DeConcini, a Democrat from Arizona and chairman of the Helsinki Commission, write in the Friday edition of the Wall Street Journal, "such a waiver would be more of a political than an economic boost to East-West trade, and it is the wrong boost at the wrong time."

Writes Senator DeConcini, "Until Soviet leaders effectively implement policies that will provide for the rapid growth of a desperately needed consumer industry, and until they transfer significant funds from the defense budget to pay for their domestic restructuring, to cite just two of the difficult tasks facing Mr. Gorbachev, U.S. trade with the Soviets will remain fairly static. U.S. economic cooperation will benefit both sides only when it is a response to reform, not a substitute for it."

This statement, it seems to me, is remarkably perceptive. In the first place, it determines the right context of discussion. The Soviet defense budget has not decreased, Gorbachev's notoriously successful charm offensive notwithstanding. There has been no indication that any major weapon systems have been discontinued.

That is the perspective, the context, in which the United States must operate. But, no less important, Senator DeConcini notes that United States economic cooperation should not be used as a substitute for Soviet reform. That is to say, the Soviets will have to do it themselves.

Indeed, I am sympathetic to those who argue that United States-Soviet joint ventures are probably more likely to delay such reform, to put off the difficult choices, rather than encourage them.

Does this mean that the United States should actually discourage joint ventures with the U.S.S.R.? Not necessarily. Here, again, I take exception to the slightly oversimple dichotomy before us.

I can see encouraging joint ventures, and perhaps principally ventures with a relatively private sector in the Soviet Union, the so-called cooperatives. But I would like to turn to one specific topic, the adoption of the Slepak principles, which, in my opinion, would be very much a step in the right direction.

These principles are not necessarily a restrictionist approach. Let me cite from the preamble to those principles. Its proponents say that we do not seek by these principles to obstruct trade, but rather to encourage the forces for liberation inside the Soviet Union.

The first principle, for example, states, "Because Soviet military expansionism poses a potentially grave danger to the United States and its allies, American companies engaged in commercial transactions with the U.S.S.R. should not contribute directly to the strength of the Soviet military."

The principle goes on to say that each signatory will attempt to ensure in consultation with the Government of the United States that its commercial transactions with the Soviet Government do not produce goods nor provide services for the military sector, or in any way jeopardize the national security of the United States.

I would respectfully take this principle at least one step further and indeed require the United States Government to provide the information necessary to ensure that no commercial transaction with the Soviet Government produces goods or provides services that in any way benefit the military sector.

I do wish to emphasize the issue of providing services, for management know-how is also strategically significant. It would probably be highly desirable, in fact, if the Government would actually provide a national security assessment of all commercial transactions, in particular joint ventures with the U.S.S.R. Congress may well decide that such assessments should be provided.

What is more, the United States should attempt to make similar requirements mandatory upon all Western allies, for no U.S. trade policy would be fully successful unless there is Western cooperation.

I expect that Sumner will address this later on. But I do want to emphasize in this connection that there is no question that the no-exceptions policy in COCOM should continue to be the rule. The abandonment of that stand would be the end of any meaningful technology protection policy for the West.

But let me return to the seven Slepak principles and cite a couple more. Labor freedom is one. American companies engaged in commercial transactions with the U.S.S.R. should not employ

goods or products manufactured by forced labor. Well, in a sense, this is simply a corollary of the 1930 Smoot-Hawley Act, which prohibits the importation of goods produced by forced labor.

Workers rights—companies should not permit Soviet employees to be dismissed without good cause, such as an individual's political or religious views, sex, ethnic, or national background, or involvement in activities protected under the Helsinki Accords.

This principle is particularly significant because it would allow a company to become something of almost an island of freedom within the U.S.S.R. It could certainly, it seems to me, become one of the issues to be negotiated at the outset of a joint venture arrangement.

The antidesecration principle, which prohibits American companies from setting up shop in former church buildings, and the prudent technology principle, which prohibits them from employing dangerous methods of production, are equally significant, and it seems to me virtually unobjectionable.

Above all, though, I wish to come back and bring attention to the last of the principles, which urges each signatory to try to reach out to the newly formed cooperatives, as a potential partner.

Again, these are not necessarily restrictive measures. Rather, they are motivated by a concern that business interests not blind us, indeed, not be pursued, at the expense of both human rights and national security considerations.

I do not wish to leave this audience with the wrong impression. It is true that I have spoken of commercial transactions in the context of both national security considerations and with a view toward democratic change in the U.S.S.R. This is not to say, however, that I believe economic considerations to be insignificant.

On the contrary, I think that good politics is also, certainly in the long run, good business. It is for this reason that commercial lending to the U.S.S.R. should take into consideration Soviet economic performance, and Soviet participation in international economic organizations should be withheld until the U.S.S.R. can show significant progress toward a free market.

I fully agree that the process of education must go on. I look forward to the U.S.S.R. learning our lesson, which is the lesson of freedom, and getting an A-plus.

Mr. BENSON. I will address U.S. policy on the transfer of strategic technology. In so doing, I will touch on several problems that were raised earlier today.

Let me recall why we have national security export controls and then indicate why these controls seem likely to remain during the present stage of relations with the Soviet Union.

The Export Administration Act of 1985 restricts the export of goods and technologies which would make a "significant contribution to the military potential of any other country or combination of countries which would prove detrimental to the national security of the United States."

Those words were carefully chosen. They were very similar to those that were chosen in 1949 for the first Export Control Act.

When we look back on the early and mid-1980's, we can understand why the United States and our allies in COCOM took major steps to improve the export administration system. We know from

intelligence estimates that have subsequently been released that in the early 1980's the Soviet Union was annually acquiring from the West 6,000 to 10,000 pieces of hardware and up to 100,000 technical documents of strategic military significance and high-technology civilian significance.

Soviet estimates were that 5,000 military projects each year benefited from Western hardware and documentation. A very dramatic example became public in 1987: the *Toshiba-Kongsberg* case. We have had other more recent cases that show that there has been no decrease under "glasnost" and "perestroika" of the Soviet effort to acquire illegally Western high-technology that has military uses.

It is the responsibility of the administration and the U.S. Government as a whole to ask why that Soviet effort has not changed.

The United States moved to correct this situation in the 1980's by moving technology security to be a central part of U.S. national security policy. As Ty Cobb said this morning, speaking as one who he helped administer that policy at the National Security Council, technology security was a key element in the overall effort by the administration and Congress to change the strategic balance and reverse the deteriorating position of the 1970's.

Is technology security still necessary?

President Bush stated in the State of the Union Message that he takes seriously the new openness in the Soviet Union. But he also said the United States should be realistic and should negotiate from strength.

Secretary Cheney and National Security Adviser Scowcroft have stated recently that it is important to maintain continuity with our successful policy of the early and mid-1980's. General Scowcroft emphasized that we have had a basic policy in place for the United States and NATO for the last 40 years. It has worked successfully. This is not the time to change it, unless there is overwhelming reason to do so.

Tim Stanley's chart (attached to his statement) is useful in this regard. Tim notes the probabilities of various changes in Soviet policy. Granting that any assessment of this type is tentative, it is interesting that when one adds the probabilities of beneficial changes to the West and the probabilities changes harmful to the West, each total comes out to 50 percent.

I think what Tim is trying to say quantitatively is what all Soviet specialists know—we don't know what is happening in the Soviet Union. We don't know whether "perestroika" will strengthen the Soviet military or whether it will weaken the Soviet military. Until we do know, it seems imprudent to abandon a policy that has worked in the past.

There are three specific reasons to maintain our present policy on technology security..

First, Soviet military leaders, for the past 10 years, have made frequent statements about the military importance of emerging technologies and how these will affect the balance of conventional forces. The new conventional weapons technologies will be particularly important in Europe because of the reductions in nuclear forces through the INF Treaty.

Marshal Ogarkov has stressed this change. Other Soviet officials have talked about the importance of sensors, communication sys-

tems, and microelectronics can help conventional weapons take over some of the role of theater-range nuclear weapons.

This is a critical change for NATO as it faces the task of countering Soviet forward-deployed forces and Soviet capabilities for a surprise attack.

The Soviets are trying to acquire these technologies from the West. There is a striking correlation between published DOD and CIA statements of what technologies the Soviet Union is seeking legally and illegally, and those technologies that the Soviet military writers describe as critical to the revolution in military affairs.

Second, NATO itself is relying on such technologies for its defense. For example, the follow-on forces attack policy uses air-to-surface and surface-to-surface weapons to attack second echelon reinforcements in a major Warsaw Pact offensive against NATO.

Secretary of Defense Carlucci stated last year that integrating advanced and emerging technologies into established NATO conventional forces is central to NATO planning for defense of Western Europe.

Earlier in the 1980's, former Under Secretary Bill Perry, Secretary Brown's Under Secretary for Research and Engineering, stated that commercially developed technologies, like computers and microelectronics could affect the military balance in Europe by bringing a shift in military planning from delivery vehicles and explosive devices to improvements in sensors, controls, and accuracy.

So, advanced and emerging technologies could strengthen Soviet offensive capabilities and could also strengthen NATO defenses. They are essential to modernizing NATO's defense in the context of the INF Treaty.

More broadly, the Defense Department is developing the competitive strategies initiative, which aims at aligning enduring United States strengths against persistent Soviet weaknesses. Enduring United States strengths means high technologies. This is where we are stronger than the U.S.S.R. We are weaker, of course, in number of troops and weapons.

A final element in U.S. defense policy is that because of congressional encouragement through the Nunn amendment, we now focus more heavily on NATO cooperative R&D programs.

There are various joint development programs—precision guided munitions, standoff weapons, and so forth. All these call for tighter security cooperation within the Alliance in order to get high-technology weapons into the hands of our allies, while preventing them from reaching the Soviet Union.

These cooperative programs call for closer coordination between NATO and COCOM policy.

That is why the United States is working with its allies in COCOM to improve our individual national export control systems, and to establish what COCOM calls a "common standard of protection" for controlled technologies. Last week Under Secretary of Commerce Paul Freedenberg noted to a conference of exporters in Washington that we are making substantial progress with our COCOM partners in this regard.

The third area where technology security is critical for the 1990's, and where I think we will get quite strong congressional support is arms control.

The lead in Western technology has been important to encouraging the reductions that the Soviet Union has agreed to already.

The history of the INF and START negotiations in the 1980's suggests that the Soviet Government negotiates most seriously when it faces the starker alternative of a Western buildup in military capabilities if it does not reach agreement on reductions.

If we are to achieve the success in conventional force negotiations that we did in INF, we must have a Western technological lead that is unquestioned, and that shows the Soviet military that the type of rapid offensive, which they have built capabilities for—I am not saying intentions, but I am saying capabilities—since the mid-1960's, cannot succeed. The Soviet military must be convinced that it is sensible to negotiate significant asymmetrical reductions that will enhance the security of both sides.

In the case of START, the Strategic Arms Talks, there is a similar issue. The START talks have progressed so that we have now reached agreement on reducing offensive forces by 50 percent on both the United States and Soviet sides.

Such reductions, however, would put a greater burden on the remaining U.S. offensive forces to maintain a strong nuclear deterrent.

We see from the *Toshiba-Kongsberg* case that losses of high technology can have an impact on the strategic balance. For example, significant additions to Soviet antisubmarine warfare capabilities could threaten the ballistic missile submarine forces of the United States and our British and French allies.

The same could be said about the technologies involved in Stealth, for penetrating bomber aircraft, which are another of the U.S. strategic nuclear triad.

Technologies like these must be protected effectively to achieve safe and verifiable arms control reductions that will be broadly acceptable in the United States and in the West.

These are the reasons why the West must maintain its edge in military-related technologies into the 1990's. If we are to capitalize on the hopes for better relationships with the U.S.S.R. and to move toward security and stability in Europe at a lower level of forces, the United States must maintain a firm, but flexible, technology security policy as an integral part of our overall national security policy. This is an approach that brought success in the early and mid-1980's. If we protect our technology edge and if the other aspects of our relationship with the Soviet Union are handled carefully, we can achieve the military stability and meaningful arms reductions that the administration and Congress both want to achieve in the next few years.

Dr. MROZ. The first point is that I think we should constantly remind ourselves of the nature of what is happening in the Soviet Union. We have danced around it a bit today. I would put it in these terms. The Soviet Union is now undertaking its third revolution since 1917. The first was industrialization, the Industrial Revolution. The second was the revolution to become a global military power.

By the way, on the first two, I am not so sure that our talk that the Soviet experiment has failed since 1917 is totally accurate, in the sense that these were the priorities of what their leadership set out to do.

I would constitute the third revolution, which we are now living through, as a consumer revolution, where the Soviet leaders are being faced with dissatisfied individuals. This, in fact, is the heart of what is happening in the Soviet Union today.

I think there are a number of elements, some of which we touched on earlier today, some of which we did not, regarding the acceptance of the fact that market mechanisms have to be introduced into the economy. Something we have not talked about too much, but which is important, is a decision by the leadership that the Soviet Union must enter a global, multilateral economic system, that that best serves the interests of the Soviet Union in the 1990's; the acceptance that open, not closed, societies are characteristic, and this ranges from statistical information on debts, credits, reserves, et cetera.

I also think we should focus very much on democratization, which is a major element. In fact, I think it is the key to success or failure of "perestroika." It's not just the March 26 elections, which we saw, but I think we can see that democratization has the potential to unleash perhaps uncontrollable forces in the Soviet Union and its republics.

These can be positive, from our point of view, against bureaucracy. But, alas, they can also be not so positive. For example, those of us who were there during the election wondered what is going to happen in 2 years when there is a referendum on price reform, about doubling the price of bread, dairy products, and meat.

If the democratization process moves forward, there is going to be an inevitable clash between the goals of "perestroika" and the process of democratization, which has been unleashed in the Soviet Union.

I also think we should remind ourselves that the United States is unlikely to ever become a major economic partner of the Soviet Union. This is a role which has gone and will go to Europe.

The Soviets seem perplexed by why we do not understand and why we do not seem to welcome the Soviet Union as they move toward democratization, market, and other Western mechanisms. What I wanted to share in the last minute is a couple of observations which a large group of us, economists, political observers, and parliamentarians from the West and from the East, who have been meeting over 9 months, has made.

There are several areas where we have come to some points of agreement, which may be worth putting on the table before we close.

The first is the genuine feeling by almost all of us that the West should accept and articulate its welcoming of the accelerated integration of the Soviet Union into the liberal global economic system.

Second is that this is a decades-long process, and that the definition of "success" should be a continuation of the process of "perestroika" and "glasnost," taken together, which will lead to more market-oriented and parliamentary-style democratic elements being introduced into the Soviet system.

Third is that we should begin to think about an interim period. Instead of talking black and white, should the Soviets be part of this system, should they not be part of the system, in the larger issues we should be talking, perhaps, about an interim period of confidencebuilding measures between the two sides, between the East and the West.

One could elaborate a long series of specific acts which the United States could take with our Western allies, and also which the Soviet Union could and should take over the next several years in a number of the areas we have talked about today, which I think could make a major difference in terms of building the basic set of belief and trust between the two of us, that the Soviet Union can, in fact, and is prepared to be a serious international partner in a changing international economic system.

Dr. HARDT. I thank you all very much for your attendance and the very valuable contributions you have made.

APPENDIX I

PREPARED STATEMENT OF TYRUS W. COBB

A PROPITIOUS TIME FOR AN EXPANSION OF U.S.-SOVIET COMMERCIAL RELATIONS

This is a heady time for those following events in the Soviet Union and the dramatically improved course of Soviet-American relations. General Secretary Gorbachev appears before the United Nations and promises to undertake radical, unilateral reductions of the Soviet armed forces, and to remove many of the armaments designed to provide Moscow's forces with an offensive capability—tanks, self-propelled artillery, bridging equipment, etc. In the USSR the developments are equally intriguing-elections are held with multiple candidates on the ballot; where only one candidate ran he often lost as citizens crossed the names of unpalatable individuals off the ballot. As the media opens up, we and the Soviet citizenry are exposed to debates over national security issues previously forbidden to open discussion. Attacks on secrecy, proposals for an all-volunteer army, and radical ideas on economic decentralization are being seriously discussed in the press.

Clearly this is a different Soviet Union and a different Soviet leader. Gorbachev has succeeded in improving the perception of the adversary we face and, in fundamental ways, has begun a transformation of the essence of that society. The changes that have been undertaken in the conduct of Soviet domestic and foreign policy have contributed to the vastly improved relationship now extant between the United States and the Soviet Union. Whether one credits this dramatic turnaround to the policies pursued by the Reagan Administration, to Gorbachev's innovations, or, perhaps to blind luck, it is undeniable that we have a qualitatively new relationship with the USSR today than we did even five years ago. And while ties between the U.S. and the U.S.S.R. have improved, perhaps the more relevant point is that America's position relative to the Soviet Union is better today than it has been at perhaps any point in the last 40 years.

I have been asked in this opening presentation to review the status of the U.S.-Soviet relationship and to assess if sufficient progress has been made on the bilateral issues on the agenda to provide a basis for expanding East-West economic ties. The answer is clearly in the affirmative. More to the point, the favorable position the United States enjoys vis-a-vis the U.S.S.R. affords us the opportunity to actively explore ways in which Soviet-American economic ties can be enhanced. Yet let us keep an important point in mind as we go forward: As the Soviets are fond of saying, it is "no accident" that we find ourselves in this enviable position. I would assert that as we analyze the next steps that might be taken it would be instructive to highlight what brought about this dramatic improvement in the relationship. This retrospective examination should suggest policy guidelines to follow in formulating initiatives that might be taken to expand U.S.-Soviet commercial ties.

THE SHIFT IN THE CORRELATION OF FORCES

Throughout the 1960's and 1970's the Kremlin exuded confidence that events in the international arena were clearly moving in their preferred direction. General Secretary Brezhnev argued that a major "shift in the correlation of forces" had occurred, "forcing the West" to abandon its preference of dealing with the USSR from "a position of strength" and to pursue, instead, a policy of detente. There seemed to be sufficient reason for this conclusion: The Soviet Union enjoyed relatively good economic growth, the leadership seemed to be united behind Brezhnev, the military was pursuing an ambitious expansion and modernization program unchecked by the atmosphere of detente, and Soviet support for so-called "National Liberation Movements" had placed the U.S. and its friends on the strategic defensive in the Third world.

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In the West a sense of despair had settled in. The United States seemed paralyzed at the highest levels following President Nixon's resignation over the Watergate scandal; economic problems—double-digit inflation, record levels of unemployment, low rates of growth—suggested systemic difficulties; the U.S., hamstrung by the "No More Viet-Nams" syndrome, failed to counter Soviet expansion in the Third World; the American defense establishment suffered through a "decade of neglect"; and our Alliance system seemed to be straining under disputes over defense issues (neutron bomb) and economic competition. As President Carter himself concluded, a "sense of malaise" had pervaded our outlook.

How far we have come in the last 10-years. The vaunted Soviet economic model is ridiculed, as much in the USSR itself than elsewhere in the world, as the Kremlin gropes for ways to recover from what is now described as the "Era of Stagnation." The leadership experienced virtual stasis from Brezhnev's last years until Gorbachev assumed the reins of power. The USSR has been forced to reconsider the wisdom of its aggressive policy of expansion into the Third World, as Soviet clients find themselves on the defensive in Angola, Afghanistan, Kampuchea and even, Nicaragua. Restiveness in the Soviet Bloc, as well as on the part of its own nationalities, threatens the cohesion of the "Socialist Commonwealth."

In contrast, a new sense of confidence pervades the Western democracies today. The United States and its Allies have enjoyed over five years of sustained economic growth. President Reagan's dynamic leadership erased much of the "malaise" that had set in, and Americans exude a new sense of confidence. The ambitious defense modernization program and an active policy of countering Soviet advances in the Third World served notice to the Kremlin that the United States had shed the "No More Vietnams" yoke. In short, the "Correlation of Forces" had clearly been reversed, and—to use the Soviet parlance—the "objective conditions" had been created that would permit the United States and its Allies to deal with the Soviet Bloc from a position of strength and confidence.

PRESIDENT REAGAN'S 5 FOUR-POINT AGENDA

The Western Allies have demonstrated a surprising degree of consensus regarding a common approach to dealing with the Soviet Union. Led by the United States, they have pursued a four-point agenda that was not always palatable to the Soviet leadership. Human rights was always first and foremost on this agenda, a subject that President Reagan refused to side-step despite strong Soviet protestations that this was not a topic that the West had any legitimate right in raising. Not only was it raised, but the President and Secretary of State George Shultz consistently placed it at the top of their priorities. Space doc's not permit a detailed review of the progress achieved in this area, but we should be encouraged by many of the developments we have witnessed-higher levels of emigration, reuniting of many families, the freeing of many political prisoners and increased tolerance of human rights activists in the USSR. Much more needs to be done, but the positive developments that our principled, tenacious approach on human rights has engendered should be recognized.

We also indicated that we wished to establish an active dialogue with the Soviets on regional issues. This has been done. However, the Reagan Administration also made it clear that it would pursue a policy of providing active support for anti-communist insurgencies in the Third World, to include the provision of some sophisticated weaponry as well as financial assistance. Just as the USSR promoted movements which espoused Marxism-Leninism, the United States sought to promote democratic forces throughout the world. Clearly this policy contributed to changing Soviet fortunes in the Third World; it also became apparent to the Kremlin that a heavy price would have to paid if they decided to continue the aggressive policies of the Brezhnev era.

Moscow has made a significant reassessment of these policies. I was struck by the admission of a senior Ministry of Foreign Affairs official who candidly stated, "Our direct and indirect involvement in regional conflicts led to colossal losses by increasing general international tension, justifying the arms race and hindering mutually advantageous ties with the West." [1] The pull-out of Soviet forces from Afghanistan, the pressure applied on its Allies to reach a Southern Africa peace accord under U.N. auspices, the Vietnamese decision to withdraw from Kampuchea, and Soviet suggestions that other clients—Cuba and Nicaragua—face reduced levels of assistance should they not adhere to Gorbachev's "New Thinking" on international security matters, all bode well for the prospects for peace and stability in the Third World.

Arms Control issues had been the centerpiece of U.S.-Soviet relations for over two decades. The Reagan Administration, however, consciously sought to lower the profile that these issues had enjoyed and to change the approach we took to arms control matters. The Administration proceeded from the precept that it would not seek agreements for the sake of agreement, but would only pursue those accords that truly enhanced our national security and that of our Allies. In doing so the U.S. and its Allies had the courage to resist tremendous pressures to make unilateral concessions—for example, to impose a "nuclear freeze" or to halt the deployments of the INF missiles that were initiated in 1983.

President Reagan also pushed hard for agreements that would not merely limit the expansion of the arms race, but would bring about deep reductions. The Soviets resisted this approach initially, but came to accept this objective in both the intermediate range and strategic missile negotiations. Third, and equally important, the United states proffered the concept that deterrence should be based on something other than a simple reliance on the threatened annihilation of each other's populations. That is, by integrating strategic defense with our offensive forces, a more rational and stable form of deterrence could be constructed.

The results of this hard-nosed approach are apparent to us all. There has been dramatic progress in the realm of arms limitations. We have signed an agreement whereby several important principles have been established: asymmetrical reductions, intrusive verification, actual reductions and elimination of forces instead of restrictions on the expansion of our arsenals, and the non-inclusion of the forces of our Allies. The results of these INF negotiations lay the foundation for future progress at the CAFE negotiations on conventional forces in Vienna and the START talks on reducing strategic arsenals in Geneva.

The last agenda itery-bilateral issues—includes a hodgepodge of problems ranging from embassy security to the establishment of new consulates, from maritime boundary negotiations to common action on global environmental concerns. I will limit my review of this subject to economic relations, the focus of today's discussions, examining first the essence of the Reagan Administration's policy and then drawing conclusions regarding the future evolution of East-West economic relations.

In the years preceding Gorbachev's assumption of power, Soviet writers frequently castigated the Reagan Administration for pursuing what was alleged to be a policy of "economic warfare" against the Soviet Union. This was never U.S. policy and most Soviet observers have abandoned such hyperbole in favor of a more sophisticated approach. [2] In an interesting twist on the "Economic Warfare" theme, some contemporary Soviet critics fault their own political and military leadership for having been "drawn into" an arms race with the United States that was designed by nefarious Reagan Administration hard-liners to "economically exhaust" the USSR. [3] Their conclusion, that the Administration deliberately pursued such a policy, is false. However, their observation, that the Soviet leadership allowed itself to withdraw into an economic competition where the USSR was at a significant comparative disadvantage, has considerable validity. And, no doubt, the decision to engage in this competition cost the USSR dearly, given the strain the system was already under in maintaining the priorities and rates of production of armaments demanded by the military-industrial complex.

In devising its policies on East-West economic relations, the Reagan Administration proceeded from the conclusion that many of the policies we pursued in the era of detente were not conducive to our national interest. [4] In particular, the provision of loans on concessionary terms, or backed by government guarantees, loans not tied to purchases of consumer goods, and the provision of export credits to promote trade with the USSR were regarded as measures that indirectly or directly assisted the Soviets in maintaining their defense production requirements. Further, a decision was taken that we should attempt to intensify cooperation with our Allies in restricting the flow of strategic technologies to the USSR, including manufactures, data and "know-how" that contributed to the production of militarily critical products. [5]

By this approach, the Administration made it clear that the USSR would have to bear the burden of its own irrational resource allocation decisions. If they chose to accord the highest priority to the defense sector, at the expense of the consumer, then it should not be up to the West to extend assistance that would alleviate the strain caused by these skewed resource allocation decisions.

The Administration also argued that improved economic relations with the Soviets depended on progress on other parts of the bilateral agenda. While President Reagan eschewed direct "linkage," he nevertheless felt that progress on the other issues on the bilateral agenda, particularly human rights, was necessary before an expansion of commercial ties could take place.

In view of the improvement that had taken place in the relationship in the last few years, President Reagan endorsed the expansion of mutually beneficial trade and economic relations in the joint communique he signed with President Gorbachev at the May 1988 Moscow Summit. And at the Toronto Economic Summit of the seven leading industrial democracies in June of 1988, Reagan and the other Heads reaffirmed Allied policy that East-West economic relations could be expanded, so long as the commercial basis was sound, and these relations were conducted within the framework of the international trade and payment system and were consistent with our national security interests.

IMPLICATIONS FOR U.S.-SOVIET ECONOMIC RELATIONS

The thrust of my remarks indicate that a qualitative change in the Soviet-American relationship has clearly taken place. Our bilateral ties have improved significantly and the basis has been laid for an expansion of normal economic ties. However, the preceding discussion also leads to the conclusion that we should understand the genesis of this improvement in the relationship, and keep these lessons firmly in mind as we proceed.

I would assert that the major lesson that should be drawn is that the approach we pursued over the last decade, dating in fact from the latter part of the Carter Administration, should serve as the basis from which we should proceed in the 1990's. A policy of dealing with the Soviet-American competition realistically, of engaging the USSR from a position of strength and confidence and a willingness to pursue an active dialogue should continue to serve as our guide.

The improved relationship provides a propitious setting for innovative new approaches to handling international security concerns. It also requires "new thinking" on economic ties, but a word of caution is in order. We should be wary of the temptation to respond to the positive shifts in our relationship with the Soviet Union by adopting certain measures "in order to help Gorbachev." We, of course, do and should continue to support the process of economic reform in the USSR and the Eastern Bloc. As President Bush has said, we want Gorbachev to succeed in implementing his program of "perestroika." We encourage, in particular, movement toward a greater reliance on the market, increased emphasis on the production of consumer goods, more support for individual entrepreneurship and greater decentralization of decisionmaking authority.

However, we should understand the limited impact that our policies can have on the success or failure of economic restructuring in the Soviet Union. The fundamental impediment to achieving economic rejuvenation in the USSR remains the continued priority the military sector enjoys in the allocation of resources. This is a tremendous burden, one that the Soviets themselves are beginning to attack. [6] A further deterrent to progress is the maintenance of centralized direction over major economic choices and the absence of a system of meaningful prices. As former Secretary of Commerce William Verity concluded, these represent "massive systemic failings that can only be solved by changing the system itself." [7]

Voices will be heard in the West arguing that we need to provide loans on concessionary terms, or with guarantees by the government, or that we should relax our controls over the export of strategic technology in order to promote trade and to assist Gorbachev. Indeed, they could argue with some justification that this could have some positive short-term impact, as it did in the 1970's.

There are several problems with this approach: the failure to understand the limited, long-term impact of these policies on the Soviet system, the deleterious effect liberalized technology transfers could have for Western security interests, and the fact that "quick fixes" of technology or capital from the west could actually lessen the sense of urgency which provides impetus to Soviet reform efforts.

Western economic assistance, principally massive lending to finance imports of Western consumer goods and modern capital equipment, can have only a limited impact. First, it is hard to believe that even the reported extension of Western credits last year—some $9 billion—would make much of an impact on an economy that generates over $500 billion in domestic investment. Further, given the extent of the Eastern Bloc debt (apparently well over $130 billion) and the magnitude of the current Soviet budget deficit, which far exceeds our earlier estimates, one must wonder about the commercial wisdom of proffering such loans and, particularly, of official guarantees for the loans. [8] At any rate, the guidelines that we have pursued over the last decade are still appropriate—Western transfers of capital should be governed by normal commercial considerations and terms, and should not be supported by government intervention based on the assumption that such assistance will "help Gorbachev."

With respect to the idea that we might relax our strategic trade controls, we should keep in mind that the major beneficiary of transfers of sophisticated technology would be the Soviet defense community. The Soviet economy has shown a general inability to absorb Western technology effectively, except the military-industrial complex. More importantly, however, in reality only a small percentage of Western goods and technologies are controlled; those with relevance for the production of consumer goods generally are not embargoed. We should endeavor, of course, to insure that export controls do not act as a barrier to the expansion of legitimate non-strategic trade. A concerted effort needs to be made to reduce the number of controlled items, with a goal to insuring that only really critical technologies are maintained on the lists ("Higher Fences around Fewer Goods"), but technologies with strategic significance should continue to be subject to Allied scrutiny.

Finally, Western government loans, credits, guarantees, insurance or other subsidies that would enable the current system to limp along could have the perverse effect of providing ammunition to the opponents of further reform. Such artificial assistance could lessen the persuasiveness of Gorbachev's argument that only by undertaking a thorough overhaul of the current system can economic progress be achieved. As Senator Bill Bradley notes, "Cheap credits play into the hands of perestroika's opponents by deferring the day of reckoning." [9]

CONCLUSION

The East cannot look to the West, as it did in the 1970's, Lo provide short-term assistance to prop up an antiquated economic system. Nor should the West be under any illusions regarding the limited degree to which it can affect the success or failure of Gorbachev's program of perestroika. Economic progress will only come in the Soviet Union when fundamental change of the economic system itself is undertaken.

We should be guided by the same sense of realism that governed our approach to East-West relations over the last decade. This does not mean that we oppose any changes in our economic policy. In fact, there are several initiatives that should be considered at this time.

First, in light of the surge in emigration levels and the progress that has been achieved on human rights, the Jackson-Vanik Amendment to the 1974 Trade Act should be repealed. This amendment prohibited the granting of non-discriminatory tariff treatment, MFN, and the provision of government credits to any non-market economy that restricted the emigration of its citizens. Although provisions were made for Presidential waivers, the Soviet government refused to accept this explicit linkage (even though it had implicitly complied with earlier understandings). Repealing the legislation would restore the President's authority to consider granting MFN, as well as to extend credits and guarantees. However, it would be premature at this time to actually grant MFN and certainly would not be wise to provide export credits. Should progress on human rights continue, or should it be necessary to provide official export credits to allow U.S. exporters to compete with officially financed exports from other countries, the President should have the authority to award MFN or authorize the credits and guarantees.

Secondly, the Administration should intensify its efforts to ascertain that only militarily critical technologies are on the strategic trade control lists. These lists are far too large at the present time and must be reduced to encompass only the most important technologies. This step is necessary not only to permit an expansion of legitimate East-West trade, but to maintain the coherence of the current system, which has come under severe criticism from our Allies and businessmen.

Third, we should consider granting the Soviet Union observer status in major international economic organizations, including the IMF and GATT. We should insist that the Soviets first comply with our demands for improved disclosures regarding their economic and financial conditions. When these are forthcoming observer status at the international economic organizations could be awarded. Actual membership in these organizations should be withheld until the USSR demonstrates a willingness to adapt its economic system to the practices and objectives of these organizations. This may be an unlikely development, but we should make it clear to Soviet officials that we are prepared to respond positively should these changes take place.

Fourth, we need to consider an ambitious program of exchanges designed to assist those Soviet organizations and representatives who genuinely desire to implement the more radical proposals that have been discussed. A Soviet economic system that is highly decentralized, relies to a great extent on the market to govern economic activity, that accords protection and encouragement to individual entrepreneurs and

that reverses the priority the defense industrial complex has enjoyed is clearly in our interest. We can offer management know-how to institutes and enterprises moving in the direction of economic accountability, for example by encouraging the U.S. Chamber of Commerce to become engaged with emerging "counterpart" organizations. The U.S.-Soviet agricultural exchange agreement is somewhat moribund and has focused on the provision of technical assistance to large agri-industrial enterprises. We should stand ready to shift our assistance to family and individual farms who wish to develop intensive, independent modes of operation. Lastly, there is some discussion that Soviet trade unions will become more representative of the will of the workers and not be simply transmission belts for the Party. The AFL-CIO should be encouraged to provide advice and assistance, as they did in Poland, to these organizations.

In conclusion, these are some initiatives that are appropriate to the vastly improved bilateral climate. By themselves they will not greatly influence the success or failure of Gorbachev's perestroika program. They do, however, represent steps that should be taken to promote a continuation of the positive developments in Soviet-American relations that have taken place.

FOOTNOTES

1. Andrei Kozyrev, "Confidence and the Balance of Interests," *International Affairs* (Moscow), p. 8. Kozyrev is the Deputy Director of the International Organizations Department of the USSR Ministry of Foreign Affairs.

2. As former Undersecretary of State Allen Wallis stated in 1983, ". . . let me emphasize categorically that we are not waging economic warfare against the Soviet Union." Wallis continued that we also do not seek a "collapse of their economy." See Wallis, "A Collective Approach to East-West Economic Relations," the U.S. Department of State, June 20, 1983, p. 3. The Administration, following its strongly held belief in the virtues of the free market, was also reluctant to impose economic sanctions on the Soviet Union. However, when the Soviets supported the imposition of martial law in Poland in 1981, the Administration announced the suspension of all licensing for export to the USSR of U.S. oil and gas equipment technology. In June of 1982, in light of the continued repression in Poland, the controls were expanded to prevent export of comparable items by U.S. subsidiaries. These controls were lifted five months later after the Allies agreed to undertake a series of analyses designed to provide a framework for a collective appraisal of East-West economic, especially energy, ties. See U.S. Department of State, "Siberian Gas Pipeline and U.S. Export Controls," October, 1982.

3. See, for example, Alexei Arbatov, "How Much Defense is Enough?" *International Affairs* (Moscow), #3, March, 1989. Arbatov makes the argument current in the Soviet Ministry of Foreign Affairs and the Academic Institutes that the United States exploited the Soviet economic downturn to force it into an arms race designed to bankrupt the USSR. Vitaly Zhurkin, head of the new Institute on West Europe, charges that the U.S. attempted to "bring about the economic exhaustion of the Soviet Union" by enticing the USSR to devote so many of its valuable resources to the mindless arms race. Also see Zhurkin, et. al., "The Challenges of Security—Old and New," Communist, January, 1988; and Andrei Kokoshin's Statement Before the House Armed Services Committee, March 10, 1989. The Soviet academic Kokoshin told the Congressional committee that "we [the Soviet Union] got dragged into an extremely costly arms race which contributed in no small measure to the worsening of the economic situation in the country."

4. Many influential figures in the Reagan Administration felt that through the extension of liberal credit terms and the virtual unrestricted flow of technology to the East, the USSR was able to maintain the traditional priority the military enjoyed. It also postponed, they felt, the day of reckoning when Soviet officials would have to seriously come to grips with the deterioration of their economic system. These officials felt that the concept of "weaving the USSR into a web of economic interrelationships" that would ameliorate their aggressive behavior internally and externally was naive and harmful.

5. The U.S. succeeded in securing agreement within COCOM that economic ties with the USSR should not contribute to the growth of Soviet military capabilities. To prevent this, improved coordination on export licensing and the enforcement of export controls was obtained.

6. See for example, Sergei Kireyev, "Cost Accounting For Disarmament Economics," *Novoye Vremya*, No. 4, January, 1989, and A. Lopukhin, "Conversion: What it Means. Problems, prospects for the Transfer of Military Production to a Civilian Footing," *Pravda*, February 14, 1989.

7. Former Secretary of Commerce William Verity, "Economic Relations and East-West Security," address to the Conference on New Approaches to East-West Security, Potsdam, June 11, 1988, p. 12.

8. For a discussion of Soviet and Eastern Bloc indebtedness, see A. Kirilov, "Are We Too Deep in Debt?," *Argumenty I Fakty*, No. 8, March, 1989, p. 6. Kirilov argues that since Soviet indebtedness is no greater than that of Brazil or Mexico, the USSR should be considered a good credit risk for Western banks. He also expresses concern, however, that any future borrowing must insure that the hard currency is utilized in the most efficient manner. He suggests that the Soviet Union in turn lend hard currency to firms, but charge a premium that reflects the real value of this scarce commodity.

9. Senator Bill Bradley, "perestroika Without Western Subsidies," *The New York Times*, January 3, 1989, p. 23.

Prepared Statement of Herbert S. Levine

INTRODUCTION

The fundamental issue facing Soviet economic reform today is the problem of transition from a centralized to a decentralized economic system. Even if the design for a new economic mechanism were perfect (which it is not), the dominant problem would still be: how do you get there from here. This paper will focus on the issue of transition—its meaning and its consequences.

THEORY OF TRANSITION

To begin, it is important to note that while there is abundant Western theory to help Soviet economists design a market system there is no available theory of transition from a centralized arrangement of economic institutions to a decentralized one. Western economists have not been concerned with this issue, since the development of decentralized economic mechanisms in the West took place slowly over long periods of time spanning more than a century. And Soviet economists themselves have just begun to work on the issue. Previously it was not a subject of concern since radical market-type reform itself was not openly discussed. Hence there are no theoretical guides, either Western or Soviet, that Soviet leaders and economists can draw upon as they attempt to deal with the problems of transition.

At the base of the transition problem is the interrelated nature of an economic system. One element of the system cannot be changed without changing other elements if true change in economic behavior is to be achieved. Thus to give Soviet managers decisionmaking power over what they are to produce, they must also be given the right to decide and the power to acquire the inputs they will use: materials, labor, and machinery.

First, if managers are to have the power to decide and to acquire what materials they will use, the institutional structure of the centralized rationing of material supply, introduced in the 1930's, has to be removed. A system of "wholesale trade in the means of production" has as a result, become a part of the design of the new economic mechanism. Conservative Soviet economists are fearful that, given the presence of material shortages in Soviet industry, the removal of the materials rationing system will cause extensive disequilibria in the economy. While supporters of reform argue that the rationing system itself contributes to the appearance of shortages, because managers, operating within the administrative centralized supply system, order an excessive amount of inputs to protect themselves against the inefficiencies and uncertainties of the system.

Second, Soviet managers have to be given increased power over the hiring and firing of workers. If managers are to be encouraged to seek out and adopt advanced technology in the pursuit of economic modernization, they have to have the right to adjust their labor force to the quantity and quality levels appropriate to the new technology. This means giving managers the right not only to fire workers who are malingering, but also those who are working hard but who are made redundant under the new technology. Thus the job security enjoyed by Soviet workers, especially during the Brezhnev period, will be decreased. And institutional arrangements will have to be expanded for the retraining and redistribution of labor. As many Soviet economists argue, the Soviet guarantee of full employment should guarantee the Soviet worker a job, not guarantee his job.

Third, managers have to have the power to acquire the capital equipment that they decide they need. This again involves the abolition of the centralized system of materials and equipment supply and its replacement with a market system of

wholesale trade. It also, however, involves the issue of investment and credit. If managers are to have the power to acquire capital equipment on their own, then they have to have access to the financial means to acquire this equipment. This led, in the initial designs of the new economic mechanism, to the setting up of various specific state investment banks. But then Soviet economists began to argue that state banks allocating credit would be a continuation of centralized planning, for state banks would use plan criteria of what is desirable for the economy as the basis for allocating credit. What is necessary, these economists argue, is the development of a system of non-state investment banks, of cooperative banks, which would, because of concern for their own economic viability, use criteria of profitability, of commercial creditworthiness as the basis for extending loans.

If this freedom for Soviet managers to acquire the inputs they decide they need is not to lead to rampant inflation, their demands must be constrained. With the removal of centralized control over supplies and labor, the constraint that must be instituted is a hard budget constraint. That is, managers must be required to cover the cost of their inputs out of the revenues they earn. If they fail to do so, the process of bankruptcy of state enterprises must be enforced. Without the development of "socialist bankruptcy," the freeing up of managerial decisionmaking will not work.

Furthermore, if managers are to make their own output and input decisions, free from central planners' control, in an economically efficient way they will need meaningful signals with regard to economic costs and benefits. Otherwise decentralized decisionmaking will lead to great inefficiency and waste. This means the Soviet price system will have to undergo radical reform. Not only will subsidies have to be removed, but the system for setting prices will have to be changed. Buyers and sellers must be given the right to negotiate their own prices in a free and flexible was so that prices adequately reflect the conditions of supply and demand in the economy.

Finally, the reforms described so far will not work without one further element, namely competition. Without the introduction of competition, without buyers being given a choice among competing suppliers, decentralization will not lead to the meeting of customer's demands, efficiency, and technological dynamism, but to monopoly, technological stagnation, and price inflation. Therefore, an additional element of the required set of reforms is the introduction of a Soviet anti-trust policy.

What all of this means is that because of the interrelatedness of an economic system, a number of reforms must be introduced more or less simultaneously in order for economic reform to begin to have any effect. In other words, to get the rocket of economic reform off the launching pad, an initial bundle of simultaneous reforms is required. One of the aims of an economic theory and policy of transition should be the pursuit of "minimum simultaneity," i.e. the development of a minimum bundle of simultaneous reforms required to launch the economic reform. For if everything has to be done at once, then the introduction of a decentralizing reform would face overwhelming obstacles. An abrupt shift from a centralized system to a full price-profit-money-market system would undoubtedly produce chaos.

In the elaboration of a theory of transition, it is necessary that the destabilization produced by the introduction of institutional changes be constrained to a level that allows the economy to continue to function. Certainly this is a policy constraint demanded by political leaders.

At the 19th Party Conference in July of 1988, Gorbachev complained bitterly that the economic reform was not showing any real progress. He criticized the officials at Gosplan and the ministries for continuing to operate in the old ways. He charged that "his majesty Val" (the gross output target) continues to reign, and that goszakazy (state orders) are being used to maintain the methods of the old command economy. But at the same time, Gorbachev continues to hold the officials at Gosplan and the ministries responsible for the performance of the economy. The only way these officials know how to carry out this responsibility is by means of the old planning and control methods.

The key problem here is that the leaders want reform, but they want to bring it about without excessively destabilizing the economy. The maintenance of some of the old forms of planning and control is necessary to prevent excessive destabilization. Thus, the transition process initially involves the introduction of new forms alongside the old forms, rather than immediately in place of them, with the idea that the new forms are to grow and in time replace the old forms. This growth and replacement process is, however, not well understood. It has not been sufficiently analyzed. Does the maintenance of old forms inhibit, or even prevent, the development and growth of new forms? What is the nature of the replacement process? Is there a magic moment when quantitative change turns into qualitative change?

This is an important area that requires attention in the working out of a theory of transition.

TRANSITION STRATEGY

The reform of the Soviet economy is, in essence, a monetization of economic transactions and decisionmaking. The target planning of the command system is to be replaced by producer and user decisionmaking involving magnitudes calibrated in monetary terms. Therefore, monetary stability becomes critical. Issues of macroeconomic policy and control—the size of the money supply and of the government deficit—become of great importance. If the required monetary control is not exercised and if reasonable monetary stability is not achieved and maintained before and along with the introduction of the bundle of reforms, then the resulting inflation will seriously weaken or even destroy the effectiveness of the reform.

Both price inflation and wage inflation are at issue. With regard to price inflation, Soviet economists argue that the appropriate strategy involves in addition to monetary stability, the initial use of a three-tier price system. Rather than freeing up all prices immediately with the introduction of reform, three categories of prices should be set up. The first tier should include the most important producer goods and consumer goods for which there appear to be excess demand. These prices should continue to be set centrally. The second tier should include producer goods of somewhat less importance or shortage. These prices should be determined through negotiation between seller and buyer with established upper and lower limits on the price changes they can negotiate. Some consumer goods can also be included in this tier, with prices negotiated between producers and retail outlets. The third tier should include producer and consumer goods, not in excess demand. For these goods, producers should be free to set prices with the market then determining whether the price was too high or low.

The strategy would be that as the reform progresses, goods and their prices would move away from tier one to tier two and eventually to tier three. Some producer goods, e.g. those designed for a specific customer would continue to have their prices determined through negotiation, but the limits on buyer-seller negotiations would be removed.

The issue of wage inflation, though related in many ways to price inflation, is a direct function of money creation resulting from managerial pressure to increase money wages within the new incentive structure accompanying the reform as spelled out in the Law on the State Enterprise. Much of the current problem of empty shelves and growing consumer goods shortages is a consequence of the recent substantial increases in money wages which would not have been possible except for the action of the printing presses increasing the supply of money (currency) in the economy.

A second part of a transition strategy involves the sequencing of reform measures. Economic reform is a long-term process. Its major payoff will come only after a long period of time, while the pain of readjustment and perhaps also of an initial drop in the supply of consumer goods will come early in the reform process. Here is where the issue of an "agriculture first" strategy enters. The argument is that, as was done successfully in Hungary and China, the reform process should begin with reform of agriculture, essentially its privatization. Since agricultural reform does not involve a strong simultaneity problem, it is easier to start with reform in agriculture. As has been shown in Hungary and China, it quickly results in significant increases in food production, which give people confidence in the reform process and thus provide political leaders with support which is so important in these early stages of reform. The same can be said for the early importing of consumer goods and modernizing the domestic consumer goods industry.

A third aspect of a transition strategy involves peripheral changes that do not directly affect the main state sector of the economy, but that may stimulate the reform of the state sector through example and competition. Included here are the development of cooperatives especially those in industry with the cooperative's leasing of the factory and its equipment; the general liberalization of foreign trade and creation of joint ventures with foreign firms, within the Soviet Union; and the setting up of free economic zones or sectors of the economy for Soviet enterprises and joint ventures.

POLITICAL ISSUES

Let me end this paper with some brief remarks about political issues. With regard to concerns the complex issue of the relationship between political and economic reform, Gorbachev appears to have concluded that political reform is a necessary

precondition for economic reform. In order for economic reform to succeed, decision-makers must have the information they need to make decisions and they must be free of arbitrary government intervention in carrying out their decisions. Leaders in government and in the economy must be accountable for the results of the actions they take. They must have credibility in the eyes of the people. Thus, glasnost and democratization are prerequisites for successful economic reform.

There is, however, an underlying tension in the politics economics relationship. An effective economic mechanism is one that produces rapid adjustment to changing conditions, to changes in technology and changes in people's desires. But adjustment involves the pain of dislocation. It reduces people's security. It affects rewards and penalties and the distribution of income. A socialist system politicizes the allocation of pain. A capitalist market system depoliticizes it. People in all countries look to their governments for protection against pain. In socialist countries, however, this feeling is very strong. Thus there is the danger that the political pressure for government protection and intervention will prevent the economy from adequately adjusting to change thus limiting the effectiveness of the economic reform.

What can be said about the current state of Soviet economic reform? Clearly, little progress has been made and there are several highly troublesome developments, in particular the growth of inflationary forces and the spreading shortages of consumer goods. On the other hand, many old obstacles to reform have been removed. And Soviet leaders and economists have hammered away at the idea that the old centralized command system has not been working. It is bankrupt and must be replaced. They have not as yet, however, provided the Soviet people with a positive ideology of a socialist market economy. What is needed is a Soviet variant of Adam Smith, one that would build faith in a socialist market economy, that it was not ruled by anarchy, but by a socialist invisible hand that will lead to the increasing wealth of the Soviet nation.

The task facing Gorbachev is to get the reform off the launching pad and to maintain its momentum. This is an awesome task. One can hardly be optimistic about his chances. Yet he is a very resourceful political leader. We have learned over the last four years not to underrate him.

Prepared Statement of Timothy W. Stanley

THE FUTURE OF REFORM IN THE USSR AND IMPLICATIONS FOR THE WEST

Before looking at the "micro" question of future commercial relations between the two superpowers, it is necessary to assess the macro-strategic questions of their overall relationship in the context of East-West relations and global politics. This paper attempts such assessments—plural for reasons discussed below.

Given the unprecedented nature of General Secretary Gorbachev's revolutionary reforms in the Soviet Union (combining perestroika, glasnost and demokratizatsiya at home with "new thinking" in foreign and security policies) it is impossible for anyone to predict the eventual outcome. For there are many possibilities.

Yet some assumptions must be made to guide Western responses to these challenges and opportunities—and they should be more rigorous in analysis than intuitive predispositions or status quo thinking. That requires sketching possible outcomes or scenarios, assigning them *relative* probabilities and "weighting" them in terms of their value, positive or negative, for the West—and indeed, the world.

The attached chart attempts such an illustrative analysis. It assumes that at some point within the next few years, the policies of Mr. Gorbachev (or any like-minded successor) will be moving toward either "success" or "failure." Of a broad range of possibilities, five of the more likely outcomes would seem to be the following: On the success track: a pragmatic, cooperative ("kinder, gentler?") USSR (CKG) or—a more efficient, modern Soviet Union with renewed ideological commitments and aggressive tendencies (EA)

On the failure side: a variant which is benign for the West because the Soviet Union is stagnant and mired in its own problems (BF); a reaction to failure which produces a military dictatorship or neo-Stalinist reversion which might need to invent and respond to a foreign "threat" to justify domestic repression (NS); or a dangerously destabilized USSR with contending factions and desperate leadership in danger of losing central command and control over its military (including nuclear and CBW) capabilities and/or facing serious and escalating ethnic disorders.(DD)

In terms of weights (values + or -) for the West, the best (CKG) might arbitrarily be given a +10, and the worst (DD) a -10. Benign failure might not threaten the West; but it would lack the benefits of Soviet cooperation on world problems and

thus could only be given a +5 at best. The Neo-Stalinist outcome might rate only a -5 because it is a model which the West has successfully contained, albeit at high costs, over many decades and which, by past experience would be inefficient. The modernized, more efficient and aggressive model would be more dangerous, perhaps a -8 on this scale.

As to probability, if one assumes arbitrarily (but quite conservatively) a 50-50 chance for the "success" track of perestroika, then the two outcomes (CKG and EA) on that track might logically divide .4 and .1 respectively. This is because for perestroika to succeed at all, glasnost, democratization and new thinking must work together. If they do, that should lead to a new, pragmatic and relatively "open" society which is unlikely to revert to past Soviet foreign and defense policies—and one which would in any case have diverted substantial resources from military programs to civilian consumption and investment.

On the "failure" track, the country (and the military-KGB) is unlikely to tolerate a disintegrating economy or potential anarchy very long; so if one assigns the BF and DD only a nominal .1 each (of the .5 failure probability) a dictatorship or neo-Stalinist restoration would have the remaining .3.

Multiplying the assumed weights by these probabilities yields the net values shown on the chart. It must be strongly emphasized that the numbers are of little validity per se, given their arbitrary nature; but the process may have some indicative value.

It suggests, for example, that the West has more to gain than to lose from the Gorbachev policies, i.e. that favorable outcomes for the West exceed the unfavorable (by a margin of +1.2); and that the "success" track has more favorable outcomes for the West than the "failure" variant (by the same margin.) And against a probability-discounted maximum of +5 on this scale, that would be nearly a 25% edge! Again, the illustrative nature of the specific numbers must be underscored; it is their net direction that may count.

Several policy inferences can be drawn from this type of analysis:

(1) No single net, assessment of the USSR is possible or appropriate; rather, policy must deal explicitly in alternative Soviet futures.

(2) Western interests do not automatically coincide with either the success or failure of perestroika per se.

(3) The most favorable outcome could have incalculable benefits for the West and the world, so that the "opportunity costs" of missing that boat could be very high and it should be encouraged in every way possible.

(4) BUT the margins are close enough that the West cannot put all its bets on any one outcome, but rather must hedge them by keeping its powder dry and alliance structure intact.

(5) However unlikely a "destabilized" USSR may be, Western planners should consider how best to reduce its probability and contain its dangers if it occurs.

(6) There is a need for NATO to agree on and then closely monitor the critical "leading" indicators of change in Soviet security and political-economic policies especially the transfer of real resources from military to civilian purposes. The highlights of the recent Atlantic Council Occasional Paper on that subject are attached as Appendix A.

Not entirely by coincidence, these inferences are supported by much more detailed analytical work which the writer has done over the past three years in collaboration, respectively, with Dr. John P. Hardt of the Congressional Research Service and Dr. Lincoln Gordon of the Brookings Institution.[1]

These studies recommend a conscious Western dual track policy toward the Soviet Union until the outcome of the Soviet evolution is clearer. One track would actively encourage and respond to perestroika and new thinking; while the other would maintain an adequate deterrence and defense against the downside risks, i.e. the unfavorable outcomes discussed above.

Such a policy also implies a "two-tier" NATO defense posture. One tier would involve smaller, less expensive ready forces which could be sustained both economically and politically during a period of rapid change in East-West relations and attrac-

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[1] The works referred to are: Hardt and Stanley, "Western and Eastern Economic Constraints on Defense: The Mutual Security Implications" (1986); Gordon and Stanley, "Integrating Economic and Security Factors in East-West Relations" (1988); and Hardt and Stanley, "Indicators of Change in Soviet Security Policies" (1989). All are *Occasional Papers* of the Atlantic Council of the United States (Washington, D.C.) However, the writer hastens to exonerate his two colleagues from any responsibility for this particular analysis, which is his alone. Similarly the views do not purport to reflect those of the International Economic Studies Institute, of which Dr. Stanley is President, nor of course of the Atlantic Council, of which he is a Director.

tive arms control possibilities. The second tier would have strengthened reserve and industrial mobilization plus R&D capabilities as insurance for contingencies in which Western active forces might require rapid augmentation.

In summary: the Soviet Union of the future may be neither an "evil empire" nor a peaceful and cooperative partner. Western policies must adapt to a wider range of possibilities and monitor those key indicators of change which will best illuminate and confirm the direction of developments in the USSR.

The period of uncertainty is estimated by some as more than a decade, at least, before perestroika can be comprehensively implemented. Other experts believe that the pressures are so great that the fork in the road lies only a couple of years ahead—a view also apparently held by key Soviet leaders. (In a December 1988 speech to a provincial party meeting in Perm, Politburo member Alexander Yakovlev said: "We probably have no more than two-three years . . . if we get cold feet when faced with the difficulties of perestroika, then destructive tendencies in the economic and moral-political sphere may acquire irreversible characteristics . . . (threatening) . . . an aggressive and vengeful conservatism.")

In the writer's view, the crunch—when the positive changes are either reversed or become irreversible—is likely to come during decisions on the 1991-95 Five Year Plan or its first years of operation, which is near enough to be well within present Western policy-making horizons.

One specific example of not being able to just "wait and see" how the Soviet Union evolves is the impact which needed constraints on transfers of strategically sensitive technologies to the East are having on Eest-West economic dynamism and specifically on U.S. competitiveness. Recommendations of a recent Aspen Institute seminar on that subject, in which the writer took part, are contained in Appendix B.

Another example is in the heavy economic pressures on Western defense budgets during a period of sharply reduced public perceptions of threat from the East. The U.S. in particular cannot sustain the force structure inherited from the Reagan build-up with level or declining real defense appropriations. Stretch-outs go only so far; so basic force and weapons tradeoffs will have to be decided while the Soviet evolution is still in flux.

What then are the practical implications for Western and U.S. policies in both the military and economic-commercial fields, assuming that a dual-track, two tier approach as outlined above is in effect? Some illustrative applications are spelled out below.

The following courses of action illustrate ways of implementing the "responsive" track. On the military side:

1. "Restart" START with a view to achieving substantial cuts and strategic stability both offensively and defensively.

2. Pursue more imaginative initiatives at the CFE negotiations in Vienna, looking to early deep asymmetrical cuts but also with substantial reductions on the NATO side, including some in airpower. Prepare to shift to a more reserve-oriented posture, and to adjust NATO's flexible response/forward defense strategy as CFE progress permits.

3. Defer any action on short range nuclear modernization, e.g. Lance, for eighteen months, to be re-evaluated in the light of CFE progress, and prepare to negotiate some mutual reductions in short range systems within the context of such progress.

4. Actively pursue data exchanges in both civilian and military channels with a view to developing leading indicators of emerging changes in Soviet military power and deployments, while sharing information on analogous U.S. and Western force planning factors and alternatives on an informal basis.

The economic components might include: (a) As an initial step, suspend the Jackson-Vanik and Stevenson Amendments (and change the Byrd Amendment to permit such suspension) with a view to eventual repeal; (b) encourage non-strategic trade and investments through policies, administrative facilitation, and government-backed credits, where appropriate. Put COCOM on a "diet" (see Appendix B); (c) Invite Soviet participation in the World Bank, IMF and GATT on an observer basis, initially, until reforms in the USSR can make participation meaningful; and (d) Stimulate cultural, scientific, and educational exchange programs, particularly those focused on economics and business management which could assist perestroika.

The "downside risk management" track would logically have the following counterparts to the above courses of action.

1. *Militarily.*—Concentrate on quick, cost-effective "fixes" for the problems of U.S. strategic vulnerability, including mobility modes. Test Soviet willingness to engage reciprocally in the same type of intrusive inspection and verification as INF on one

or two specific strategic systems or subsystems. Intensify "basic" research on SDI technologies, while deferring operational planning.

2. On conventional forces, continue qualitative NATO force modernization and improvement activities, while developing an enhanced reserve force and mobilization potential, with particular attention to rapid U.S. reinforcement of Europe.

3. Establish a standby production capability, but without actual production for Lance; avoid actual accords on sub-INF nuclear forces until asymmetrical first stage cuts in Pact conventional forces have been verified.

4. Engage in exploratory discussions with the USSR on how relative symmetry might be maintained in mobilization and reinforcement capabilities after a postulated deep cut in active forces; and re-examine the role of mobilization (industrial and reserve forces) in the U.S. and allied defense postures.

Economic risk management elements could involve such options as: (a) Keep the restrictive amendments on the books so that their suspension could be canceled in the event of a reversion to harsh Soviet civil rights practices and reversals in glasnost; (b) Accompany any relaxation of trade controls by intensified emphasis on narrowly defined critical strategic technologies. Insist that dual-use categories involve non-diversion verification. (Once a technology or critical end-item has been "transferred," it can never be recaptured.) Reinforce existing NATO and OECD undertakings about limiting credit to the Soviet Union to commercial terms with limited exceptions for government guarantees) but with no government subsidies; (c) Calibrate any Soviet participation in world economic and financial institutions (beyond observer status) to progress in applying market forces, publishing economic data, and providing limited convertibility of the ruble, etc; and (d) Be prepared to suspend or cancel those exchange programs of interest and benefit to the Soviet Union in the event of major reversals in new thinking, glasnost and perestroika, and apply multilateral measures to limit Soviet access to Western technologies and information.

In summary, it will be prudent for Western countries to coordinate their policies, constraining the inevitable diversity within common guidelines, and to keep both their military and economic "powder" dry even as they pursue and explore the responsive track. While explicit "linkage" should be avoided, the Soviet Union will understand that the West does have a dual track policy, and that relaxation of its restrictive elements naturally assumes continued progress in Eastern domestic and foreign policy reforms. The growing interactions of economic and security factors in East-West relations will need to be addressed more explicitly and coherently in Western planning.

CHART—FIVE POSSIBLE SCENARIOS

[To accompany discussion paper on the Future of USSR Reform]

	Scenario/ outcome	Weight/ value	Probability	Net
Favorable Outcomes for West (+)	CKG	+10	.4	+4.0
	BF	+5	.1	+0.5
				+4.5
Unfavorable Outcomes for West (-)	NS	-5	.3	-1.5
	EA	-8	.1	-0.8
	DD	-10	.1	-1.0
			1.0	-3.3

Probable Success (CKG + EA) = .5
Probable Failure (BF + NS + DD) = .5

1985 86 87 88 89 90 91..?

Abbreviations: CKG = Cooperative and Kinder-Gentler. BF = Benign Failure. EA = Efficient-Aggressive. NS = Neo-Stalinist. DD = Dangerously Destabilized.

Prepared Statements of Gary K. Bertsch and Steven J. Elliott

INTRODUCTION

On April 1-5, 1989 more than forty of the world's leading East-West trade experts met at the University of Georgia for the 12th International Workshop on East-West Economic Interaction on "The Impact of Governments on East-West Economic Relations." They came from the Soviet Union, East and West Europe, and the United States to discuss issues such as the integration of the Soviet Union into the world economy, U.S. East-West trade policy, reforms in Eastern Europe, and EC 1992.[1]

Debate in the closed sessions was candid and lively. There were agreements and disagreements but one thing was clear to all present: the changes taking place in the Soviet Union are real and dramatic, largely irreversible, and likely to have great economic and political consequences. And while they will continue regardless of the Western response, the pace and nature of the changes can be affected by that response. Consequently, the West has a unique opportunity—what some have called a "window of opportunity"—to affect change in the Soviet Union and Eastern Europe.

Before responding, however, American policymakers need to be aware of current thinking in the Soviet Union regarding perestroika, Soviet integration into the world economy, and the range of U.S. options. Glasnost and a little democracy in the Soviet Union have led to public debate about the future of perestroika. This was evident at the workshop in the divergent views of the four Soviet participants and expert Western observers present. The fact of disagreement among Soviet participants at this sort of meeting is worthy of comment in itself. In the past disagreements may have existed but would only have been apparent to the most seasoned Soviet-watchers. Glasnost prevailed in Athens, Georgia and the Soviet differences and disagreements were clear to all present. These disagreements reflected some of the divergence of opinion in the Soviet Union on the pace, form, future, and implications of perestroika. Of course, there was also disagreement among the participants on the Western response to perestroika.

Drawing upon relevant papers and discussion at the workshop, this paper reports on recent thinking in both East and West on perestroika and the range of possible Western responses.[2] The focus is on the changes and proposed changes in Soviet international economic policy and, in particular, the movement towards greater Soviet involvement in the international economy.

SOVIET THINKING AND POLICIES ON INTEGRATION INTO THE WORLD ECONOMY

One of the workshop sessions addressed the nature and significance of the changing attitudes toward East-West economic relations in the Soviet Union and of the Soviet political response to the changing economic conditions. Jerry Hough's paper started by asking why there has been so little serious public discussion within the Soviet Union of the process by which the Soviet economy would become integrated into the world economy. Discarding the idea that this was due to the incompetence of Soviet economists, he suggested that it may result from the government's desire not to arouse workers' fears about foreign competition or the difficulty of using Lenin's ideas to legitimate an opening to the West. Hough also suggested several hypotheses for the current Soviet leadership's efforts to open their economy to the global market. He suggested that their actions were a response to the needs of a new "middle class" in the bureaucracy and the labor force. The actions might also be seen as part of an effort to rebuild the power of the Soviet state and to stimulate internal economic reform. Finally, Hough examined the path and timing of the reform process now underway in the Soviet Union, ending with a forecast that the Soviet Union is on the verge of a very significant expansion of its external integration effort. Valdimir Andreff's paper was primarily concerned with the side effects that Soviet efforts to integrate into the world economy might have on the East European economies' relations with the West. He was concerned that there could be a

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[1] A list of participants and the program are included as Appendices A and B.

[2] The papers prepared for the workshop and the discussants' comments will be available in book form in the Spring of 1990: Gary K. Bertsch and Steven J. Elliott, eds. East-West Economic Relations: The Impact of Governments (London: Macmillan, forthcoming, 1990). Much of the remainder of this paper consists of summaries of the workshop discussions and extracts from relevant papers. The summaries were prepared by Dr. Dan Bond, Vice President of the U.S. Export-Import Bank, whose assistance the authors gratefully acknowledge. It should be stressed that the workshop participants were expressing their own views and not necessarily those of their institutions or governments.

"crowding out" effect, with western firms finding trade and investment opportunities in the vast Soviet market more attractive than in the East European market. Nikolai Shmelev's paper began with the assertion that export and import of capital should become normal in the Soviet Union and continued by examining how foreign capital could be utilized to advance the current domestic reforms. He also pointed out that internal reforms, especially price reform and the transition to a convertible currency, are necessary if increased integration is to be of benefit to the Soviet economy.

The discussion which followed showed that there was considerable disagreement about several of the issues raised in the papers. First, there was disagreement as to how much Soviet thinking has changed since the Brezhnev era as regards the desirability of Soviet integration into the world economy. Second, there were quite different views taken on the path such integration should take and the consequences that would derive from each. In particular there was a lively debate on the issues of Soviet use of western credits and questions of where the Soviet economy's comparative advantage lies. It was also felt that Soviet integration into the world economy was being held back by the difficulties being encountered in introducing reforms into the domestic economy. The causes of the slowness of improvements in performance on the domestic front were disputed. The age of the Soviet Union's capital stock was suggested as a major problem. But others felt that the major impediment was the lack of competent and interested management and the lack of adequate incentives for the workers.

There was general agreement, however, that in the process of becoming integrated into the world economy, it would be necessary for the Soviet Union to go beyond the simple exchange of goods. The Soviets will also find it necessary to take into account the vital role of multinational production and the accompanying inflow and outflow of capital and technology. The exchange of people, ideas, and experiences was also considered essential. There was general agreement that the Soviet reforms currently being discussed would take considerable time to implement and even more time would be required before a significant improvement in economic performance could be expected.

Extracts from selected papers:[3]

Bogomolov on Soviet involvement in the world economy

As regards the Soviet Union and many other socialist countries, the orientation of their governments to [an] expansion of business relations with the West unquestionably becomes stronger. One may say that a qualitatively new situation is being formed here.

The Stalinist model of construction of a socialist society assumed substantially isolation from the world economic relations, since they could not be subjected to planning, [and] bore the threat of dependence on the hostile capitalist world. The new thinking rejects the faith of dogmata established over the decades. It rests on the concept of interdependence of the world and its individual regions, on the necessity of taking this into consideration in foreign policy, to follow the line of a broad economic interdependence, while retaining technological and economic invulnerability only in vitally important areas. This means . . . greater openness of the soviet society and its economy to the outside world, [and] an active involvement in the global division of labor [and] the system of world economic relations. The new political thinking assumes observation of the balance of interests of the participants with due account of particular expectations and specific interest[s] of each partner in world economic relations.

These changes in [the] general foreign policy concepts of governments of many socialist countries are followed by more practical steps. For example, the Soviet Union has declared its desire to take part. . .in discussions and solution of global economic problems and matters of regulation of the world economy. Following the same objectives, it has put forward the principle of insuring the economic security of the state; i.e., the creation of [a] world economic order under which each state would abstain from actions directed explicitly against the economic interests of other states. This principle necessitates consideration of the objective needs and trends of world eco-

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[3] The papers extracted here are: Oleg Bogomolov, "The Role of Governments in the Development of East-West Economic Relations and the World Economy;" Valdimir Andreff, "The Soviet Foreign Trade Reform as a Challenge to Eastern European Economic Relations with the West;" Nikolai Shmelev, "The Interconnection between World Markets and Planned Economies," Jerry F. Hough, "The Soviet Attitude Toward Integration in the World Economy;" and John P. Hardt, "Challenge of Openness and Normalization: The Changing Government Role in East-West Commerce." These extracts are not for citation.

nomic development leading to a gradual consolidation of countries (not their confrontation with one another), and, consequently, making harmonization of their interests indispensable. .

Bogomolov on joint ventures, free economic zones, and transnational corporations

In the USSR a radical reform of external economic activity is ongoing. 22,000 state and cooperative enterprises have obtained the right of a direct . . . access to the world market. Their economic interest in the efficiency of external economic operations has increased; the system of monetary self-financing and crediting was introduced along with exchanges of foreign currencies between them on the basis of auctions.

The creation of joint enterprises with a foreign capital on Soviet territory has been allowed; now they number more than 260. The corresponding legislation was revised several times towards its liberalization and now it corresponds to international norms. The possibilities for participation of Soviet enterprises in joint entrepreneurship abroad were extended including establishment of joint shareholding and other companies.

The next step is [the] creation of free economic zones at the East and West of the country with [a] special preferential regime for business activities of both Soviet and foreign organizations and firms. It is intended to introduce a Soviet convertible currency in these zones. Later on it is possible to use it on a larger scale.

The governments of socialist countries will define to a decisive extent the approach to such a form of international cooperation as transnational corporations. Today they became the main motor of international trade. Western governments encourage their development in every possible way, [and] insure protection of their interests. Socialist countries do not have such corporations yet and on their territory still there are no necessary conditions for business activity of affiliates of Western transnational corporations. Elaboration of a new political approach to this problem can provide a strong effect on East-West economic relations. . .

Bogomolov on regional and international organizations

Being fully aware of the importance of further progress of the unique Helsinki process, the necessity of intensification of the all-European cooperation, the USSR and other East European countries supported the idea of establishing a "common European home" and strive to fill it with real content. They have already suggested specific measures both in the military and political spheres and in the economic, ecological, and cultural areas. It is intended to gradually shape an appropriate infrastructure which would help to overcome the division of Europe and to build a common European home from the Atlantic and the Urals. It should be noted that common European cooperation is far from being regarded as a counterweight in respect of interaction with other countries and regions.

The Soviet Union has formulated the task to enhance its economic and political significance in the vast Asian-Pacific region where the gravity center of the world economy and policy is being gradually shifted. The USSR has proposed a program for the development of broad mutually beneficial cooperation . . . meeting the interests of all countries of the Asia-Pacific region. The [Soviet] government undertakes measures to involve the resource-rich Soviet Far East in trade, production, [and] scientific and technological cooperation with China, Japan, the newly industrializing states of the Asia-Pacific region, the U.S.A., and other ASEAN countries.

Taking into consideration a growing significance of international organizations in the development and regulation of world economic relations, the Soviet government came to the conclusion of the necessity of a more active participation in them, [the] promotion of their authority, and [the] improvement of their efficiency. The matter is not only in the UN [and] its special and regional institutions but in other international organizations as well. The USSR, for example, has declared its readiness to join the GATT, [to] interact with other international economic organizations and financial institutions, [and] to facilitate their constructive activities in all directions, including [in] East-West cooperation.

Andreff on Soviet foreign trade strategy

Let us . . . look at the USSR's new foreign trade strategy. Gorbachev has repeatedly stated that the USSR is now in favor of the strongest possible development of its international economic relations. As Aganbegyan has emphasized, the USSR accounts for roughly a fifth of world industrial production but only a twentieth of world trade. Between 1975 and 1985, Soviet trade with the West has only increased by one third and it has stopped increasing since 1981; it has even decreased since 1985. Western countries' share of Soviet foreign trade fell from 33.6% in 1980 to 23% in 1986. Thus, the main objective is to decentralize foreign trade, to eliminate

existing barriers between domestic and external markets, and to link [the] performance in external markets more closely with wages and profits of those enterprises involved. The medium-term objective is to create a strong export-oriented complex within the Soviet economy, which would considerably alter the country's present export structure in favor of manufacturers and sophisticated products.

Soviet strategy concerning the country's economic relations with the West is aimed not only at increasing exports of finished goods, machinery, and equipment, but also at increasing the degree of processing of exported raw materials, fuels, and foodstuffs. The principle Soviet goal is to become a major world exporter of machinery, equipment, and technology. According to Ivanov (1986), the country has a long record in exporting machinery, particularly machine tools, aviation technology, optics, cars, mining, [and] agricultural, transport, and other equipment. However, machinery is still a long way from dominating Soviet exports in 1984 it accounted for only 12% of the total value of exports in comparison to 22% in 1970.

The USSR's foreign trade strategy is also aimed at imports. Bulk imports of grain, metals, and some basic chemicals have to be substituted domestically; the saved currency is re-allocated. In machinery-related sectors, more imports will be used for modernization and less for new construction. The machine-building sector will be the leading importer, followed by agriculture, the energy sector, infrastructure, and consumer goods industries. It is expected that purchases of consumer goods will be partly redirected from Western Europe and Japan to developing countries.

Shmelev on planned economies in the world market

The prospects of [the] "opening" of the Soviet economy depend mainly on us, but not only on us. Full-fledged participation of the Soviet Union in international economic affairs, [and the] opening of its vast domestic markets for international cooperation, is also in the interest of our foreign partners. It seems that now, in view of obvious positive changes in the international political climate, the time has come to eliminate those artificial barriers [that are] in the way of economic cooperation [and] that are left behind by the "Cold War" There are many such barriers. But ,in my opinion, the most significant among them are, first, trade and political discrimination against the Soviet Union in domestic markets of certain Western countries, including the U.S.; secondly, the unreasonable scale of restrictions that COCOM places not only on military-oriented products (which is more or less natural) but also on a broad range of "high technologies" relating to civil sectors; thirdly, the political assessments of [the] normalization of economic relations with the West in terms of a new "Marshall Plan," not needed by socialist countries, which today mainly seek generally-accepted commercial norms of international business partnerships; fourthly, political attempts to hinder [the] access of the Soviet Union [to] or, at least, a more active cooperation of the Soviet Union [in] such international organizations as GAff, IMF, [and the] World Bank.

Does perestroika (the restructuring of the Soviet economy) need assistance by the West? Yes, it does. But the Soviet Union needs assistance, not charity. Assistance differs from charity in that it is mutually beneficial. The matter at hand is not Soviet problems but the new opportunities presented by perestroika in global economic, scientific, [and] technological cooperation from which everyone can benefit.

Hough on Gorbachev's foreign economic strategy

Mikhail Gorbachev has three major interests that are relevant in understanding his foreign economic strategy.

First, Gorbachev must maintain control over a very different population than existed in the Soviet Union in the 1 960's, let alone in earlier decades.

The second interest that Gorbachev must pursue is the rebuilding of the power of the Russian state. . .

The third interest that Gorbachev must pursue—and in a sense it is the most important—is to find an economic reform that will actually work. . .

Hough on the future of Soviet foreign trade reforms

Clearly 1989 will . . . see a significant acceleration of reform in the foreign trade area. The right to trade abroad is being extended to all state and cooperative enterprises; the joint venture law has been considerably liberalized; a first experimental domestic auction of foreign currency is being introduced; laws legalizing foreign economic zones seem imminent. One should also note the foreign policy steps that have been taken to facilitate the development of foreign economic relations. Emigration of Jews has been increased in an attempt to relax the Jackson-Vanik laws, while substantial concessions have been made to China to promote an improvement of economic relations with it. Most important of all, Gorbachev has made very major

changes in the military realm—both a virtual withdrawal of the SS-20 missiles and a unilateral reduction in troops—in order to reduce the sense of threat in Europe.

The question is how rapid will the expansion of foreign economic relation be? Obviously many of the changes introduced this year are in the same experimental category as steps taken earlier. As such, their major impact will be felt in 1990 and 1991 at best. Obviously a really large-scale increase in foreign economic activity depends not only on an increase in the freedom of Soviet economic enterprises to undertake it, but also on their having an incentive to do so. So long as the Soviet enterprises have a captive domestic audience, they have relatively little reason to test the much more rigorous foreign market. Real changes in the supply and incentive system promised in existing legislation must be introduced in practice.

My own belief is that we are on the verge of a very significant expansion in Soviet foreign economic relations over the next two years. . . [T]he opening of Russia to the world economy is likely to go much faster than we expect.

Hardt on new Soviet thinking

Soviet new thinking in international affairs calls for a more pragmatic, less military-centered foreign policy, ergo fewer forward deployed offensive and intervention forces and less military aid and sales. Withdrawal from Afghanistan, possible agreements in South Africa, South East Asia and apparent resolution of the Iran-Iraq war, new initiatives in the Middle East are all examples of the new thinking in foreign policy. The new thinking implications for foreign policy reform laid out by Foreign Minister Shevardnadze in July 1988 indicated that the traditional military-driven foreign policy was often too costly and counterproductive. A model for regional settlements has been suggested with the U.S., and USSR as a great power guarantors of crises resolutions.

Hardt on Soviet constituency for foreign commerce

In order to be successful in attracking enough joint ventures and exports, it would seem necessary to make working in the Soviet economy attractive for Western partners through special zones; preferences in terms of freedom from tariffs and taxes; special arrangements to assure supply of high quality inputs and quality control of exports, etc. The result could be more exports in value-added materials-refined petroleum products and petrochemicals, pulp and processed wood, energy intensive processed metals, and also manufactured goods. Objectively, judging by successful Asian developed economies, successful foreign trade should be assigned first priority in the economy even higher than defense.

With first priority justified by burgeoning hard currency earnings and effective technology transfer the influence of its foreign commerce constituency should rise. Indeed, in the short run, if foreign economic relations contribute a critical margin to putting quality food on the Soviet table, improved quality of care in the medical system, better controlled environment and improved housing, the political-economic benefit could be crucial to the success of perestroika. If improvements in the efficiency of the energy chain from well to pump can substantially increase the hard currency earnings, [the] foreign economic sector may claim considerable credit and prestige. Even with small but critical foreign commercial sectors the domestic constituency for interdependence may increase in importance. As the foreign trade and investment activities from the West become more important the reciprocal importance of commerce to the success of perestroika and expanding market shares would lead to development of important constituencies or interest groups effecting the governing bodies both in East and West.

AMERICAN THINKING AND POLICY

Another of the workshop sessions was devoted to addressing various aspects of the role of the U.S. government in East-West economic relations. The authors of the papers and discussants considered the extent to which the U.S. government would eventually reconsider the national security and foreign policy imperatives behind U.S. policy towards the Soviet Union, in particular, but also towards different East European countries. In the discussions one could distinguish at least three approaches to these issues:

(1) Continuation of current U.S. policies (a status quo, "wait and see" approach);

(2) Greater involvement in economic relations with the intention of supporting the changes taking place in the Soviet Union and selected East European countries; and

(3) Questioning whether it was in the West's interest to strengthen the USSR and other East European countries.

Some remarks were also made as to how each of the three approaches would affect relations between the United States and its Western allies. There was also

some discussion of more subtle and differentiated U.S. economic policies toward socialist countries. (Some East European participants were particularly keen to see greater differentiation in U.S. East-West trade policy.)

A number of the non-U.S. participants expressed some impatience with the lack of response by the U.S. government to what they viewed as major efforts by the Soviet Union and some East European countries to create the objective preconditions for more normal East-West economic relations. In response, American authors and participants stressed the complexity of decision-making processes in the United States, and the substantial differences among various U.S. institutions with regard to the East-West economic relations.

Extracts from selected papers:[4]

Shmelev on U.S. East-West trade policy

Entering the last decade of the 20th century, both East and West face a choice which is no less momentous . . . than that they were confronted with after the end of WW2: how should they conduct their economic relations in an interdependent world; [and] what guidelines, principles and mechanisms will best serve their long-term national and international interests as the world economy . . . undergoes profound technological change? The solution of these problems would to a large extent define the world economic order of the next century, and the prospects for military confrontation being superseded by the binding forces of the international division of labor.

The U.S., being the military and economic leader of the West, has to make an important choice too. The four decades that have elapsed since the end of WW2 have shown that a bipolar world based on U.S.-USSR confrontation offers too few opportunities for [a] productive East-West economic relationship. Of course, the fundamental differences between the market economies of the West and the administrative economies of the East have impeded progress too. It is also true that the policy of military-strategic competition has left a deep imprint on the modus vivendi of both U.S. and the USSR as regards trade and technological cooperation. However, one cannot be blind to the fact that, with rare exceptions, American policy towards East-West economic cooperation has been devoid of constructive objectives, leaving no room for mutually acceptable compromises. "The worse it is for the East, the better it is for the West" type of thinking has dominated American policy. The U.S. has made trade hostage to its military and political interests in its relationship with the East.

Shmelev on the need for new U.S. thinking

[T]he USSR and its allies have made practical rather than theoretical steps towards erasing the "enemy image" in East-West relations. But is the United States prepared to meet us halfway?

Indeed, some positive developments are already evident. But they, with rare exception, have not involved East-West economic relations as United States policy is dominated by old stereotypes rather than by the seeds of new thinking. If one looks exclusively at the facts, then one is bound to see that today the United States export controls remain in place the way they were during the crisis period of the early '80's, whereas the scope of this organization has even broadened as new developing countries have been pressured to join it. The USSR and a number of other socialist countries continue to be discriminated against in terms of trade and credit regimes. The United States continues its old East-West "containment" policy in economic relations which is this time directed against their Western allies which are ready to respond to [the] opportunities offered by the economic and political change in the East.

For now, the official choice in Washington in terms of East-West economic relations gravitates towards the old pattern which is the legacy of the confrontation period; the "stop" and "go" policy is highly probable to survive in bilateral economic relations. It looks like West European and Japanese governments which are closely tied to the United States commercially, financially, and technologically are closely watching the United States lead. . .

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[4] The papers extracted here are: Nikolai Shmelev, "The U.S. Policy of Participation in East-West Economic Relations;" John P. Hardt, "Challenge of Openness and Normalization: The Changing Government Role in East-West Commerce;" Richard Kaufman, " U.S.-Soviet Trade Policies in the 1980's;" and Carol Rae Hansen, "U.S. Policy on East-West Trade." These extracts are not for citation.

Shmelev on the importance of depoliticizing U.S.-Soviet economic relations

One could continue looking for more or less plausible arguments which explain the United States reluctance to assume the role of a strong lead of transforming the whole spectrum of East-West economic relations in order to bring it in line with internationally recognized ways of economic intercourse. Of course, one could continue waiting for more serious breakthroughs in arms control, and for better results of the economic reforms in the USSR and in other socialist countries. But the favorable climate which has developed in international relations in the late '50's may never occur again. No one can guarantee that the momentum in arms control can be sustained. The creation during a short time frame of East-West economic linkage through greater trade, technological and industrial cooperation, and through joint ownership of assets could preclude possible crises in non-economic East-West relations. Past experience shows clearly enough that political relations cannot become stable unless there is also simultaneous economic repprochement and a greater degree of cooperation in solving world economic problems. . .

J. Hardt notes with justification the beneficial impact of trade normalization on arms control and on lowering tensions in the USSR and United States relations with its allies.

What is the realistic alternative to current United States policy in East-West economic relations? The time has come for economic relations to no longer be completely subordinate to political relations. The objective is to make economic relations into a separate, independent component of U.S.-Soviet relations and "deideologize" economic relations. This implies that the United States should no longer use economic relations to gain unfair advantages and concessions, and should give up using embargoes and sanctions for political purposes. . .

Shmelev on a common inter-governmental approach to economic relations

[S]uch an [inter-governmental] approach [to economic relations] should be built on the principle of reciprocity. Since the USSR is going to introduce tariff and non-tariff instruments of regulating trade, the USSR, the United States, and their allies could immediately start work on granting each other "most favored nation" status. One tends to agree with American experts who say that MFN would not lead to a rapid growth of Soviet exports. However, such a step would radically change the general climate of the trade and political relationship and create a basis for a future economic repprochement. . .

Shmelev on the importance of political cooperation

Regardless of the policies of the United States, the Soviet Union's position in the world economy will not change rapidly. However, the political upshot of more close cooperation in the political sphere will be felt immediately. This would make a strong positive impact on the complex of factors which determine the development of modern international relations.

To continue, we must think together about ways of adjusting to the changes in the structure of international economic relations. No single state can halt the objective flow of events. In any case, the openness of the Soviet economy will increase. However, unless there is political support, this process can be full of conflict and pain. Thus, right now, the objective of creating a firm political foundation for a new mechanism of economic interaction which would make it possible for the world community to face the 21st century in a civilized way is becoming a practical issue.

Hardt on human rights and economic normalization

U.S. policy has established a special relationship between human rights and economic normalization. The Soviet Union's perceived domestic discrimination—the nationality question—and restrictions on emigration are issues of particular interest to the United States. Tolerance of Jewish national or ethnic cultures and an acceptable emigration policy for Soviet Jewry and Armenians are specific areas of U.S. interest. To the extent that restrictive nationality policies have limited the human resources available for Gorbachev's ambitious programs, he may have greater interest in equality of opportunity. Elimination of the self-induced "brain- drain" caused by restrictive nationality and ethnic opportunities, such as the prohibition of teaching of Hebrew on the grounds that it is a religious language and discrimination in educational and employment opportunities, may liberate more productive reserves for what is called the "human factor" in perestroika.

Release of refuseniks, clarification and narrowing of "security" as a basis for emigration denial, and expansion of individual rights to include practices consistent with cultural and religious traditions as highlighted in the General Secretary's December 7, 1988 UN speech, might increase Soviet productive reserves for energizing the human factor in Gorbachev's reform program. This might entail risk, from the

Soviet perspective, of increased emigration of talented people, at least initially. Such steps, however, would likely generate positive responses within the CSCE process, especially from the United States. Based on the U.S. policy of relating commercial benefits to human rights, substantial progress by the Soviet Union in these areas tends to make issues such as tariffs, credits, and a CSCE meeting in Moscow more negotiable. Furthermore, such change would provide a basis for a more congenial summitry process.

U.S. conditional acceptance of [the] Soviet proposal to have a Moscow meeting of the CSCE in 1991 was concrete evidence of American and Western acceptance of a favorable process of human rights improvement.

Kaufman on protectionism in US-Soviet trade

U.S.-Soviet trade policies can be seen as the products of dual protectionist systems. On the Soviet side, protectionism is systemic in an economic sense, supplemented with political decisions about particular trade issues and trade partners. On the American side, selected protectionist policies are directed at perceived Soviet threats to national security and strongly held values such as human rights. Soviet policy is also influenced by a perceived American military threat.

The results are the same regardless of the origins of protectionist policies—trade relations are obstructed, but what needs to be done to remove the obstacles differs. On a theoretical level all such trade problems may be soluble. As a practical matter, in the case of the Soviet Union and the United States, some of them may be intractable. For example, so long as each is seen as an adversary and a military threat to the other, full "normalization" of trade will not be possible.

This dualistic view of the subject underlines the necessity for analysts to look at the two sides. What is unusual about the 1980's is that there were initiatives in both countries to address some of the underlying causes of U.S.-Soviet overall relations, a precondition to progress in the trade area, each has taken important steps. The most fundamental changes may be in the area of military policy.

Continued progress in arms control and a reduction in military burdens would go far. towards moderating the mutual perceptions of the two countries. The fact that the Soviet leadership has announced its intention to reduce military spending, and that U.S. military spending has been constrained since 1985, is encouraging. However, it will take actual reductions in spending and capabilities to change perceptions.

Kaufman on export and credit controls

Among the challenges for the United States are the need to rationalize and contain export controls, and to respond appropriately to Soviet actions and signals. Again, there are signs of progress. The Reagan Administration, prodded by Congress, began the process of streamlining the enforcement of export controls, achieving better cooperation with the Western allies, and de-emphasizing the use of controls for foreign policy objectives. U.S. policy seems to be moving toward a targeted definition of the products and technologies that should be subject to controls. Concerning the statutory prohibitions on MEN and official credits, the government so far has responded correctly to signs of changes in Soviet emigration policy by indicating a willingness to consider waiving Jackson-Vanik. In some respects, the controversy over Soviet borrowing in Western commercial markets was the most encouraging development. The government's deliberative and analytical response was exactly right.

Hansen on the need for caution

[The] new enthusiasm for expanded U.S.-Soviet trade must not conflict unduly with other important policy goals. . .

In addition, certain key commercial issues must be handled carefully. Credits should be strictly linked to growth-producing enterprises that can generate the foreign exchange needed for repayment. Further, business should be alerted to the risks of doing business in the Soviet Bloc, with the understanding that joint ventures are purely commercial undertakings. The U.S. government should stress that it has not undertaken to reimburse, subsidize, or otherwise reimburse firms that fail in the USSR or otherwise fall short of expected success.

The best U.S. approach is a cautious one; watching for the Soviets to display their cards more openly, and waiting for Soviet reforms to go beyond the theoretical stage, particularly with price reform, the key to the entire process. For foreign trade reform, crucial for expanded U.S.-Soviet trade ties, is inextricably linked to domestic reforms, and these may already be in trouble. Over the long term, the U.S. should be able to reap political gains from encouraging Soviet economic reforms, more pluralism, and a better economic lot for the Soviet people. However, it must not abridge its own interests in doing so, or invest too much in a ship that might sink.

Similarly, it would be unwise to appear to be freezing the Soviets out of the information and technological revolution, for a hungry and isolated Soviet Union would be exceedingly dangerous.

In this process, the U.S. should not expect major changes to occur too quickly. Many factors currently combine to insure that the volume of U.S.-Soviet trade is a small one: the growth in Soviet-Comecon trade, U.S. sanctions imposed for foreign policy purposes that led to a diversification of Soviet grain imports, Gorbachev's desire to reduce the USSR's vulnerability to Western sanctions, COCOM's strategic export controls, U.S. credit limitations, and Soviet hard currency shortages.

However, if perestroika succeeds, interdependence with advanced industrial economies, including joint ventures, science and technological exchanges, and participation in the international economic system will become more relevant for Gorbachev. The U.S. and the West must be cautious, however, for one long-run goal of the Soviets is the renegotiation of the world's trading relationships, and the playing of a key role in that renegotiation. The U.S. must take the lead in insuring that the USSR does not disrupt through future membership of bodies such as the IMF, the World Bank, and the GATT, where at least a modicum of consensus reigns. The West has no obligation or incentive in giving the Soviets a key role as an independent actor in international economic relations; they must earn it.

Similarly, joint ventures should not be pushed too rapidly. Current Soviet law is vague and imposes restrictions on Western equity holdings and profit repatriation. The U.S. government could facilitate investment by clarifying the following: control of U.S. equipment and the quality control process, access to domestic markets, ability to repatriate profits in hard currency, assurance of supply and work environments conducive to quality and timely deliveries, and access to foreign supply and market networks and systems.

In terms of trade and finance, the U.S. can negotiate effectively with the Soviets by offering economic incentives. In principle, U.S. trade with the Soviet Union should, as much as possible, promote a linkage between economic reform and political liberalization. Likewise, the U.S. should concentrate on promoting trade as a means of improving human and religious rights performance in the USSR, and perhaps more easily in Eastern Europe, using both bilateral ties and the CSCE process. the time is certainly ripe to move on key trade-related legislation such as import control on goods produced by slave labor, and to respond aggressively to Soviet efforts to diffuse criticism of their religious performance by highlighting a "Millennium of Christianity" in Russia. Emigration of ethnic Germans, Armenians, Jews, Pentecostals, and other religious minorities has recently increased after a long drought, and should be a renewed focus for U.S. policy.

Given the Jackson-Vanik amendment's central role in U.S. human rights policy, the U.S. must be prepared to rebut a Soviet push for a one-year "trial" waiver of the Jackson-Vanik and Stevenson amendments to the Trade Act of 1974—to secure Most Favored Nation (MEN) status and renewed access of U.S. Exim-Bank credits, until and if sustained high levels of emigration are guaranteed. Moreover, efforts to amend Jackson-Vanik or to initiate broader legislation concerned with human and religious rights as a whole should be put on the legislative agenda for 1989.

American must also be prepared to deal with what may be the "pipeline controversy of the 1990's:" U.S. government and commercial credits that subsidize Soviet trade with the U.S. The debate over extending credits to the Soviets is a hot one, but it must be resolved before we can move forward in bilateral trade relations. Given the Soviet's ample gold reserves and excellent credit status, as well as human rights issues such as slave labor and emigration, the U.S. government should not subsidize Soviet trade. Current U.S. credit limits under the Jackson-Vanik, Stevenson, and Byrd amendments should be retained unless broad and substantial improvements in human and religious rights—not just emigration—occurs and is sustained for all groups.

Hansen on the need for long-term research and policy

A heightened focus on U.S.-Soviet trade must go far beyond the Bush Administration and the next summit; it must focus on a series of Summits and Administrations. U.S. policy needs to be as subtle and sophisticated as recent Soviet policy development has been, preferably more so. A bold U.S. strategy must also be informed by a much greater investment in studying the Soviet Union. Currently, the U.S. spends but $5 million a year under the congressionally mandated Title VIII funds for the study of the USSR and Eastern Europe, while it is estimated that the Soviets spend some $400 million annually in studying the U.S. alone.

CONCLUSION: THE ROLE OF GOVERNMENTS IN THE DEVELOPMENT OF EAST-WEST ECONOMIC RELATIONS AND THE GLOBAL ECONOMY

The workshop ended with an assessment of the future role of governments in either facilitating or impeding East-West economic relations, and a discussion of the relative importance of political and economic considerations in the making of East-West trade policy in the future. John Hardt, Oleg Bogomolov, and Wolfgang Heinrichs provided the initial summary statements.

New positive thinking in the Soviet Union, the Soviet willingness to participate in the world economy and international organizations, global problems connected with the internationalization of economic affairs came to the fore in Oleg Bogomolov's remarks. Starting from these world economic tendencies, Heinrichs' contribution stressed that major changes must first occur among CMEA—countries themselves. John Hardt took a rather optimistic approach, considering normalization as a movement towards a liberal government role in West-West commerce and a liberal East-West commercial regime, within which perestroika and openness may raise the priority of foreign economic ties in the USSR and may lay the groundwork for a Soviet constituency for greater foreign commerce.

In the discussion, some participants noted that the prospects for continued improvements in East-West economic relations were somewhat hindered by the uncertainty about how economic reforms are progressing in Eastern Europe, about the links between the "Common European Home" and the rest of the world economy, about the role and impact of future internal and international government policies, about how welcome East European countries will be in international organizations in the future, and about the continuance of steady economic growth in the West. All the participants seem to have agreed that East-West relations are in a process of fundamental change as a part of the continuing integration of global markets.

Extracts from selected papers:[6]

Hardt on the impact of politics and economics on East-West economic relations

Politics has dominated East-West commerce in the past and government intervention has been mainly restrictive. That seems to be true in the future. A clarification of the future interrelationship of politics and economics in East-West commercial behavior is essential in order to improve the accuracy of Western forecasts of East-West commerce, and for assessing the government role in commerce.

In West Europe, except for inter-German relations, politics have been less of a factor in foreign commerce. Although Western political authorities also involve themselves in trade issues on grounds of security, sovereignty, and maintenance of the pluralistic market system, their interventions either to facilitate or to restrict trade are not, as a rule, central to the commercial relations. This has not been the case with the United States where arms, regional issues, and human rights have been the centerpiece of U.S.-USSR relations or with Japan where security concerns and the Northern Territory issues have overshadowed commercial considerations. As the political environment between the United States and the Soviet Union appears to be qualitatively changing, the prospects of normalization or facilitation of commerce by the respective governments seems more likely than in the past.

The key to [the] development of U.S.-Soviet economic relations is a general improvement of the political environment.

Heinrichs on the political environment affecting East-West economic relations

With a negative portent still in the first half of the '805 characterizing the political sphere [of] the development of East-West economic relations, more propitious conditions have emerged in the second half of the '80's not only for a revitalization of East-West economic relations but also for a diversification of their forms in line with the technological challenges and the world-wide economic interdependence of [the] present and [the] future. Already today the policies pursued by governments are faced with great challenges in shaping the general political conditions. Obviously this is likely to continue in the '90's as well.

The establishment of official relations in 1988 between [the] CMEA and EC, and the establishment of diplomatic relations between the individual member countries of [the] CMEA and EC will on a long-term basis lend themselves to an improvement of general political conditions for economic cooperation between the two big econom-

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[6] The papers extracted here are: John P. Hardt, "Challenge of Openness and Normalization: The Changing Government Role in East-West Commerce;" Oleg Bogomolov, "The Role of Governments in the Development of East-West Economic Relations and the World Economy;" and Wolfgang Heinrichs, "Perspectives of East-West Economic Relations in the 1990's: The Demands of Politics." These extracts are not for citation.

ic organizations and between individual member countries and organizations. Even the CSCE process, notably the results reached in Vienna in 1989, testified to the long-term interest in East and West to unfold into economic cooperation. . . It is possible to refer to additional tendencies and factors, documenting that [the] general political conditions have invariably improved for East-West economic cooperation and that there is a real chance now of putting [cooperation] on a [more] stable foundation for a longer period.

Given the progress reached in favor of the general political conditions it has to be frankly stated that, apart from several neutral countries such as Austria, Finland, and Sweden, the foreign economic policies pursued by various Western states and groups toward CMEA countries are not yet constructive enough and show still illusory aspects.

In this context, reference again has to be made to the technology blockade and, specifically, to the continuation of traditional and the introduction of new, yet more subtle varieties of discrimination. A trading policy of differentiation borne by political motives vis—vis the member countries, tariff and non-tariff protectionist restrictions by Western industrial countries or the EC, which generally put CMEA countries at a gross disadvantage, are doubtless part of a set of negative factors that affect the general political conditions of East-West economic cooperation. In all probability these factors will continue to be operative in the '90's—even with heightened intensity. Even by the end of the '80's it will not be possible, notwithstanding all the advances made, to speak of a state of normalcy in the political climate of East-West economic relations. If this abnormality should last into the '90's, not only discouraging but also decelerating factors in East-West economic cooperation will have to be reckoned with as the affects of the political climate. It is less the traditional form of commodity exchange that would be especially affected [than] the formation of more complicated forms of cooperation, such as specialization, delivery of equipment and factories, [and] joint ventures.

Bogomolov on the Western response to perestroika

In my opinion, the policy of the leading Western countries in respect [to the] involvement of the USSR in the activity of international economic organizations—needs revision. It is high time to lift the barrier hindering the Soviet participation in them. The new political thinking advocated by the Soviet Union requires nonconfrontation, complimentary development of the two systems, [and the] recognition of a contradictory, but integrated and interdependent world.

The success of perestroika is not only [a] question of life for us, for our future, but it is also a positive factor of global importance . . . [N]ot only because it contributes to [the] elimination of confrontation with the West and thus insuring peace on our planet, [but also because] it opens up the perspective of [the] inclusion of the Soviet economy into the world economic process, which will make the global structural and technological perestroika more rational and successful. The sooner the official policy of the West takes into account political and economic benefits stemming from Soviet perestroika, the greater are its chances for success and the chances of mankind's survival.

Today vividly discussed in the West is the idea of a certain "Marshall Plan" in support of perestroika in the USSR and some other socialist countries. This idea appears to be utopian, since no one is ready for free financial aid and [since] additional Western credit can overburden the economies of many socialist countries experiencing a difficult period rather than render any noticeable help. At the same time, assisting perestroika in other forms is possible.

For example, these can be [the] abandonment of different forms of restrictions on the part of the West of technology transfer, granting most favored nation treatment to socialist countries, [and] furthermore, the investment of Western capital in joint enterprises or affiliates of Western companies on the territory of these countries or in special economic zones created [for] them. A promising way might be assistance in training managers in these countries. The scientific potential of the USSR and of a number of East European countries might be engaged in international scientific and technological programs such as "Eureka." Opportunities should be found for [an] expansion of imports of consumer goods from the West to these countries on the terms of certain liberalization of reciprocal deliveries to the West of some kinds of final products, foodstuffs, [and] raw materials. But the most efficient assistance of the West to such countries as Poland and Hungary is obviously revealed in facilitating the present terms of repaying their indebtedness in hard currency.

[There] is no doubt that [the] governments of the leading countries of the world will provide a strong influence on East-West economic relations [and] on [the] solu-

tion of global problems in the future. We can hope that this influence will be more effective and coordinated and [that it] will be affected [by] new political thinking.

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Program

Welcome and Opening addresses
G. Fink (Aus.), P. Rieger (Aus.), G. Bertsch (USA)

Session 1. The impact of governments on East-West economic relations

This opening session will establish a framework in which to discuss the roles and impacts of governments on East-West economic relations. It will pose a set of central questions, and some secondary questions, to be addressed in subsequent sessions from the perspectives of different governments East and West. Briefly, the central questions involve consideration of: a) the motives of decision makers and the decision making structure of foreign economic policies; b) the demands made on governments regarding East-West economic relations; c) how governments respond to these demands and other challenges; and d) the constraints on the roles and impacts of governments; (of special importance here will be the affect of national security and foreign policy considerations on foreign economic policy and the constraints placed on smaller states by the leading powers).
Chair: M. Hillenbrand (USA)
Papers: A. Lenz (USA), P. Sydow (GDR)
Discussants: O. Bogomolov (USSR), N. Kloten (FRG)

Session 2. The changing attitude of the Soviet government to integration into the world economy

This session will address the nature and significance of the changing attitudes toward East-West economic relations in the Soviet Union and of the Soviet political response to the changing economic conditions. Broadly speaking, the papers will address new thinking (and actions) in the Soviet Union about cooperative engagement in the world economic organizations, such as: Soviet interest in joining the GATT, Soviet promotion of a UN conference on world economic issues, interest in other international economic organizations, new Soviet relationships with the United States and with the European Community, and specific bilateral relations with other developed Western states.
Chair: N. Kloten (FRG)
Papers: Y. Andre O. Bogomolov N. Shmelev (USSR), W. Andreff (Fr.),J. Hough (USA)
Discussants: D. Bond (USA), H. Berman (USA), A. Kunitsyn (USSR)

Session 3. The politics of U.S. participation in East-West economic relations

The session will address various aspects of the role of the U.S. government in East-West economic relations. Addressing the central questions raised in the open-

ing session, authors will consider issues such as: the extent to which U.S. government has impeded or facilitated East-West economic relations; the national security and foreign policy imperatives behind U.S. policy; and the politics of U.S. policy-making towards different East European countries and the USSR (including the role of non-governmental actors regarding such issues as human rights, technology transfer, and so forth). The authors from the East will also consider the impact of U.S. policy on their economic relations with the West and the reaction of their governments to U.S. policy.
Chair: O. Bogomolov (USSR)
Papers: C. Hansen (USA), R. Kaufman (USA), U. Plowiec (Po.), N. Shmelev (USSR)
Discussants: S. Eckert (USA), F. Levcik (Aus.), H. Nau (USA), D. Vojnic' (Yug.)

Session 4. East European governments in East-West economic relations

In addition to the issues addressed in previous sessions, papers here will pay particular attention to the reform in foreign economic relations taking place in Eastern Europe and their relationship to East-West economic relations. Of special interest will be papers that discuss the impact of economic reforms, and national security and foreign policy considerations on East European governments' EastWest trade policies. Also, how do Soviet foreign economic reforms affect the other CMEA countries' involvement in East-West trade? How do East European governments balance their interest in Western technology with the longer term goal of producing comparable technology indigenously to avoid dependency? How do these other considerations impact on the East-West trade and technology transfer policies of the various East European governments?
Chair: F. Levcik (Aus.)
Papers: L. Lang (Hun.), V. Komarek (Cz.), A. Lukaszewicz (Po.), P. Marer (USA), T. Bacskai (Hun.)
Discussants: J. van Brabant (UN), A. Rudka (Po.), J. Tesche (USA)

Session 5. The role of West European and Japanese governments in East- West economic relations

As well as some of the issues above, important issues to be explored in this session concern the movement of the European Community to a unified market in 1992, and recent agreements and further developments in EC-CMEA economic relations. And to what extent are West European and Japanese East-West trade policies influenced by the American government? How do these and other issues affect the roles and- impacts of the Japanese and West European governments?
Chair: P. Sydow (GDR)
Papers: I. Commeau-Rufin (Fr.), F. Gehart (Aus.), L. Haus (USA), J. Jahnke (FRG), D. Rosati (Po.), K. Schneider (EC)
Discussants: C. Allen (USA), Y. Andreev (USSR), K. Dyba (Cz.), J. Mclntyre (USA), I. Nomura (Jap.)

Session 6. Conclusion: The role of governments in the development of East-West economic relations and the global economy

An assessment of the future role of governments in either facilitating or impeding East-West economic relations, and the relative importance of political and economic considerations in the making of East-West trade policy in the future. What is the role and impact of governments likely to be, given the changing domestic and international political economies?
Chair: G. Fink (Aus.)
Papers: 0. Bogomolov (USSR), J. Hardt (USA), W. Heinrichs (GDR)
Discussants: M. Hillenbrand (USA), N. Scott (UN)

Prepared Statements of Glennon J. Harrison and George D. Holliday

EXPORT CONTROLS: POLICS AND ISSUES

In the post-World War II period, U.S. laws have authorized export controls for three purposes: to preserve national security; to prevent domestic shortages and inflation; and to further U.S. foreign policy. Export controls have been used most frequently for national security purposes, primarily to restrict U.S. exports of dual use technologies to the Soviet Union and other Communist countries. The U.S. Government has also imposed foreign policy controls on exports to the Soviet Union and other nations to signal U.S. disapproval of their domestic or foreign policies.

BACKGROUND

The Export Administration Act of 1979 is the primary authority for controlling exports. The Act provides a dual mandate: it calls on the President to encourage trade with all countries with which the United States has trading relations, but directs him to restrict the export of goods and technology which would make a significant contribution to the military potential of adversary countries. The dual mandate has created a dilemma for those who administer export controls: how does the government further the goals of export control policy without undermining the competitiveness of U.S. exporters on international markets? Proponents of stronger, more comprehensive controls argue that U.S. technology exports contribute significantly to the military power of the Soviet Union and its allies. Advocates of less restrictive export controls argue that the current export control system undermines the international competitiveness of key U.S. industries with scant security benefit.

The debate over export control policy has complicated U.S. relations with its allies. The U.S. and other allied governments coordinate export controls through the Coordinating Committee on Multilateral Export Controls (CoCom), an informal, nontreaty organization that includes all Japan and all Nato member countries except Iceland. The U.S. Government has frequently differed with other CoCom members in assessing the dangers of exporting dual use technologies to the Soviet Union and its allies. In CoCom, U.S. negotiators have generally urged other governments to broaden the categories of goods subject to controls and to improve their enforcement of export controls. Other members, while supporting controls on items which could contribute directly and significantly to Soviet military power, have resisted controls on lower level technologies, and, by U.S. standards, have not put sufficient resources into enforcement.

Concerns among U.S. policymakers that other CoCom members have not adequately controlled exports of militarily significant technologies have sometimes led to unilateral U.S. measures. Thus, the U.S. Government has controlled some exports that other CoCom countries do not; it has required licenses for some exports to other CoCom countries; and it has required licenses for reexports within CoCom of U.S.-origin goods and technologies. Some observers, in both the United States and other CoCom countries, think that such measures have imposed significant barriers to West-West trade and technology transfer.

During the 1980's, a major review of U.S. export control policy by the Reagan Administration and a key assessment of the effects of national security controls by the National Academy of Sciences (NAS) have provided evidence for both sides of the debate. Several reports issued by the Department of Defense and the intelligence agencies, for example, claimed that U.S. export controls have not been tight enough and have allowed transfers of militarily significant technologies to the Soviet Union. Evidence that the Soviet Union had benefited militarily from Western technology convinced the Reagan Administration to impose tighter export controls.

The NAS, on the other hand, published a report in 1987, which generally supported those favoring less restrictive controls. While affirming the necessity of export controls, the study argued that the cumbersome export control mechanism, by harming U.S. competitiveness and allied unity, weakened, rather than strengthened U.S. security. It found that the scope of U.S. controls was too broad, encompassing so many products and technologies that the Government could not effectively administer the export control system. The Reagan Administration responded to the NAS and other criticisms of the export licensing process by reducing the processing times for reviewing license applications, expanding the use of distribution licenses (special 2-year licenses that authorize the export of eligible items to approved end-users), and decontrolling some exports to other CoCom countries.

OMNIBUS TRADE AND COMPETITIVENESS ACT OF 1988

Complaints about the administration of export controls led to a major reform of the Export Administration Act in the 100th Congress. The Omnibus Trade and Competitiveness Act of 1988 (OTCA; P.L. 100-418) included amendments to reduce the disincentives that the established export control system provided to exporters and to strengthen enforcement of U.S. and multilateral export controls.

REDUCTION OF DISINCENTIVES

The reduction of export disincentives is to be accomplished through a streamlining of licensing requirements, control list reduction, and improved procedures for making foreign availability determinations. The OTCA also provides for the use of distribution licenses for multiple exports to the People's Republic of China.

Streamlining of License Requirements

The OTCA eliminates license requirements for low technology exports to free world countries (specifically, those goods that can be exported to controlled countries without multilateral approval—so called "AEN level" goods and technology). For exports to CoCom countries or countries which participate in cooperative agreements, known as 5(k) countries, export licensing requirements are eliminated for goods that can currently be exported to the People's Republic of China without multilateral approval (so-called "PRC green line level" goods and technologies). The threshold level for requiring licenses for exports to CoCom and 5(k) countries was raised from the AEN level to the PRC green line level.

The OTCA also requires the Secretary of Commerce, within 3 months of enactment, to determine which CoCom and 5(k) countries have effective export control systems, and to eliminate all licensing requirements to such countries. The objective of this provision is to achieve a license-free zone among CoCom and 5(k) countries. License requirements for reexports of goods and technology among CoCom and 5(k) countries were also eliminated, as were requirements for parts and components incorporated into foreign made goods when U.S. content amounts to 25 percent or less of the total value. The OTCA provides that the Secretary of Commerce may require notification of such reexports, but the report of the conference committee states that such notification, if imposed, should not be required prior to such reexport.

Control List Reduction

The OTCA provided for the elimination of export controls for low technology items ("AEN level" goods and technology) within 6 months of enactment, unless CoCom agrees to maintain notification requirements for specific goods or technologies. Export controls were also removed from medical instruments and equipment, unless the functional characteristics of the good as a whole would make a significant contribution to the military potential of a controlled country which would prove detrimental to the national security of the United States.

The OTCA also eliminates from the control list a broad range of goods subject to unilateral control by the United States. Unilaterally controlled goods were to be removed from the control list within 6 months of enactment or 6 months after imposition of such unilateral controls, unless the President is engaged in negotiations to achieve multilateral control, or unless the item is unique to the United States and no foreign availability exists. In cases where negotiations are underway to establish multilateral export controls, the items must be decontrolled if no multilateral agreement has been reached after a maximum of 2 six month periods have passed.

Dispute Resolution

In response to complaints from exporters about delays caused by disputes between the Departments of Commerce and Defense, the OTCA provides a timetable for the resolution of interagency disputes over license applications and over the inclusion of items on the control list. If the Secretary of Defense fails to make a recommendation or provide notification within the specified 20 day period, or if the President fails to notify the Secretary of Commerce that he approves or disapproves the export, the Secretary shall then act upon the license application. The conference report also clarifies that the role of the Secretary of Defense is limited to national security, not foreign policy, considerations.

Foreign Availability

The OTCA establishes a maximum of 9 months for making foreign availability determinations, provides new guidelines for making such determinations, and provides a clear definition of the term foreign availability. The OTCA also provides for the decontrol of goods that are found to be available in those Western countries that do not belong to CoCom or maintain 5(k) agreements with the United States (West-West foreign availability).

Expansion of Trade with the PRC

P.L. 100-418 authorizes the use of distribution and comprehensive operations licenses for exports to the People's Republic of China (PRC), and permits U.S. exporters to display technology and equipment at trade shows in the PRC if they retain title to the goods on display. The use of distribution licenses will facilitate exports to the PRC.

STRENGTHENED ENFORCEMENT

The OTCA provides for stronger enforcement of U.S. and multilateral export controls.

Violations of U.S. Laws

In the case of persons convicted of violations of the Export Administration Act of 1979 or the International Emergency Economic Powers Act (P.L. 95-223), the Department of Commerce is authorized to bar such persons from applying for or using export licenses. Such authority is also extended to parties related through affiliation, ownership, control, or position of responsibility to any person convicted of violations.

Violations of Foreign Laws or Regulations

In response to the Toshiba-Kongsberg diversion of militarily sensitive equipment to the Soviet Union, the Congress passed the Multilateral Export Control Enhancement Amendments Act (Sections 2441-2447 of the OTCA).

Toshiba/Kongsberg sanctions

Mandatory sanctions were imposed retroactively on Toshiba Machine Company of Japan, Kongsberg Trading Company of Norway, their parent firms, and their subsidiaries. Toshiba Machine, Kongsberg Trading, and any other foreign persons involved in the diversion are barred from U.S. Government contracting and procurement, and are also prohibited from exporting goods to the United States for a period of 2 to 5 years. The President may exempt certain transactions from the prohibitions. The parent corporations (Toshiba Corporation and Kongsberg Vaapenfabrikk) are subject to a 3-year prohibition on U.S. Government contracting and procurement. The intent of the sanctions is to punish the companies for violations of CoCom regulations and to further U.S. national security interests.

Prospective sanctions for future violations

In addition to imposing import penalties against a Japanese and a Norwegian firm, the Act provides for prospective mandatory sanctions against any foreign person that violates any regulation issued by a country to control exports for national security purposes pursuant to the CoCom agreement. Such violation must have resulted in substantial enhancement of Soviet and East bloc capabilities and must be determined by the President to represent a serious adverse impact on the strategic balance of forces.

The sanctions which the President may impose include debarment from U.S. Government contracting and procurement and a prohibition on importation into the United States of all products produced by a sanctioned person. Sanctions are to be applied for a period of 2 to 5 years. The President is also required to initiate discussions with the foreign person and the government with jurisdiction over that foreign person regarding compensation in an amount proportionate to the increased costs to the U.S. and allied governments for research and development of new defensive systems. The Attorney General may also seek civil damages against the violator, any person (including corporations, subsidiaries, and affiliates) owned or controlled by the violator, and any person who owns and controls the person who committed the violation.

The OTCA also provides discretionary authority to impose sanctions for up to 5 years on foreign persons that have violated CoCom regulations. Discretionary sanctions may be imposed in those cases where no serious adverse impact on the strategic balance of forces occurred.

ISSUES FOR THE 101ST CONGRESS

In considering the reauthorization of the Export Administration Act (it was extended to September 30, 1990 by the OTCA), the 101st Congress is likely to reexamine many issues in U.S. export control policy. Overseeing the implementation of the many changes mandated by the OTCA may be a first order of business. In particular, the Act sets several deadlines for action—a new report by the NAS on the adequacy of national security export controls; certification of CoCom countries with effective export control systems; and removal of U.S. unilateral export controls. The Congress may also examine ongoing efforts to streamline the commodity control list, resolve jurisdictional disputes between various departments involved in export controls, and improve the administration of multilateral export controls. Legislation to amend the Export Administration Act to establish controls on private lending has already been introduced in the 101st Congress.

IMPLEMENTATION OF THE OMNIBUS TRADE ACT AMENDMENTS

The Administration has already begun to implement some of the changes required by the OTCA. In testimony before the House Foreign Affairs Subcommittee on International Economic Policy and Trade in March 1989, Paul Freedenberg,

Under Secretary of Commerce for Export Administration, gave a status report on measures that the Department of Commerce had taken.[1] The Department of Commerce has: removed unilateral national security export controls, though it still controls some items unilaterally for foreign policy reasons; published a proposed rule allowing reexports to CoCom and cooperating countries without prior U.S. authorization; published a proposed definition, for export control purposes, of a "supercomputer;" established a new general license, permitting the export of many additional items to CoCom and cooperating countries without licenses; published a proposal to increase to 25 percent the allowable percentage of controlled U.S. content in a foreign made product that could be reexported without U.S. Government approval.

The Administration's progress on, and experience with, these and other measures mandated by the OTCA is likely to shape the congressional debate over reauthorizaton of the Export Administration Act.

Streaming the Control List

For many critics of the current export control list, the key to reform is a reduction of the commodity control list. Many exporters agree with the NAS report that the Government tries to control too much. Many who export high-technology products believe that the list is seriously outdated. Freedenberg, in his congressional testimony, appeared to support such criticism, noting that the list of controlled machine tools had not been revised in 15 years.[2] By reducing the list and focusing controls on truly criticaltechnologies, critics maintain, the Government could more effectively furtherU.S. national security goals.

Removing items from the list, however, is often a difficult and controversial process. Those concerned about the military implications of technology transfers note that even older technologies can aid Soviet military efforts. Complicating the process is the absence of clear statutory guidelines on what constitutes a "significant contribution" to an adversary's military power. Past efforts to devise new criteria for the control list, such as the militarily critical technologies list, have not resulted in a smaller list. The OTCA directs the NAS to address this problem in its new study. The study is to "identify those goods and technologies which are likely to make crucial differences in the military capabilities of controlled countries . . ." and to "develop criteria by which to define those goods and technologies."

Dispute Resolution

Export controls have, since World War II, been an important element ofU.S. national security policy. During the 1980's, however, as U.S. export performance declined, some exporters blamed overly stringent U.S. export controls for some of the lost sales abroad. The globalization of manufacturing and the rapid diffusion of new technologies to countries that either do not participate in controlling exports, or that have weak systems of control, placed additional pressures on U.S. exporters. Recently, U.S. policy has moved in the direction of greater reliance on multilateral controls and the achievement of common (and higher) standards for CoCom/5(k) countries.

Within the U.S. Government, however, jurisdictional disputes among the Commerce, Defense, and State Departments over which technologies are strategic and the conditions under which high-technology goods should be exported continue to generate complaints from exporters. U.S. exporters have, for many years, complained that interagency disputes cause lengthy delays in the approval of export licenses. The Departments of Commerce, Defense, and State have overlapping and shared jurisdictions in the areas of civilian dual-use exports and arms exports.

While the OTCA sought to clarijurisdictional issues and provide stricter time limitations for decisions on license applications, it is not clear that this will happen. In his March 1989 testimony, Undersecretary of Commerce Paul Freedenberg said that one of the most important issues that Congress will deal with when the reauthorization of the Export Administration Act is taken up is the dispute resolution process. Freedenberg noted that jurisdiction remained a problem and recommended tight guidelines and time limitations.

Financial Export Controls

Some members of Congress have expressed concern about an increase in lending by Western banks to the Soviet Union. of particular concern is lending by Western

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[1] U.S. Congress. House. Committee on Foreign Affairs. Subcommittee on International Economic Policy and Trade. Statement by the Under Secretary of Commerce for Export Administration Dr. Paul Freedenberg, March 9, 1989.

[2] Ibid.

banks that is not tied to specific trade transactions. Those concerned about such lending have voiced three kinds of objections. They fear that the Soviet Union, in an effort to modernize its economy will become heavily indebted and unable or unwilling to service its foreign debt. They are concerned that easy Soviet access to foreign credits will obviate the need for Soviet leaders to make hard choices between military and civilian spending. They also are concerned that untied credits can be used by the Soviet Government to finance foreign client states that pursue policies that are injurious to U.S. interests.

Such concerns have led to efforts to amend the Export Administration Act to authorize the President to monitor or restrict private lending to the Soviet Union. Proponents of such an approach have already introduced legislation in the 101st Congress. They argue that the authority to control financial flows to the Soviet Union is a logical and necessary complement to controls on exports of goods and technologies. Opponents maintain that such controls are unnecessary and would not be effective without cooperation from other Western governments (which many believe is unlikely). Neither the Reagan nor the Bush Administration has supported legislation to control private credits. An interagency task force report in November 1988 found no reason for concern over Soviet creditworthiness.[3] Moreover, President Reagan's national security advisor Lt. General Colin L. Powell voiced the Administration's opposition to controls on private lending. He maintained that, while controls on exports of strategic products were essential, it was not in the U.S. interest to restrict private credits used for non-strategic trade.[4]

MULTILATERAL EXPORT CONTROL ISSUES

Reexamination of the "No Exceptions" Policy

Following the Soviet invasion of Afghanistan in 1979, the United States adopted the "no exceptions" policy as a sanction against the Soviet Union. Under the "no exceptions" policy, the United States votes to deny all applications for export licenses which fall into the CoCom General Exceptions category (a category of goods and technology that includes strategically sensitive high technology). Export license applications that fall into the CoCom General Exceptions category require unanimous approval by all CoCom members. Although other CoCom members initially objected to the "no exceptions" policy, the United States was able to exercise a veto because of the requirement that decisions be by unanimous consent.

The "no exceptions" policy was continued by the Reagan Administration and, after the downing of Korean Air Lines flight 7 by the Soviet Union, this policy was reaffirmed by the Congress and incorporated into the Export Administration Act of 1979, as amended: "It is the policy of the United States, particularly in light of the Soviet massacre of innocent men, women, and children aboard Korean Air Lines flight 7, to continue to object to exceptions to the International Control List for the Union of Soviet Socialist Republics, subject to periodic review by the President." [5]

Since the "no exceptions" policy went into effect in 1980, no approvals for General Exceptions category exports to the Soviet Union have been granted. The Soviet withdrawal from Afghanistan refocused attention on the policy. Other CoCom members reportedly asked that the "no exceptions" policy be withdrawn once the Soviet army had completed its withdrawal from Afghanistan.[6] Additionally, during the final 3 months of the Reagan Administration, a widely reported debate between the State and Defense Departments took place over whether the policy should be continued.[7]

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[3] Report of the Special Interagency Task Force on Western Lending to the Soviet Bloc, Vietnam, Libya, Cuba and Nicaragua, November 8, 1988.

[4] Lt. General Colin L. Powell, Speech to the American Stock Exchange, November 8, 1988, reported in the Washington Post, November 10, 1988.

[5] Section 3, Paragraph 15 of the Export Administration Act of 1979. (50 U.S.C. App. 2401, P.L. 96-72).

[6] Oberdorfer, Don. Schultz, Carlucci Drew Battle Lines on Trade: Curb on High-Tech Sales to Soviets at Issue. Washington Post. January 26, 1989.p. A22.

[7] Bureau of National Affairs. Modification of MFN Ban, CoCom Controls Policy for Soviets Seen Likely In 1989. International Trade Reporter. February 1, 1989, pp. 142-143; Bureau of National Affairs, Gejdenson Wants Foreign Affairs Panel to Prepare for Export Policy Review. International Trade Reporter. March 22, 1989, p. 353-354; Inside U.S. Trade. Undersecretary Sees Change in U.S. Export Control Policy Towards Soviets. March 24, 1989. pp. 9-10; Oberdorfer, Don. West Europe Challenges U.S. Trade Sanctions, Baker Said to Resist Lifting Curbs on Soviets. Washington Post. February 7, 1989. p. A19; Bryen, Stephen D. Don't Sell High Tech to Moscow. New York Times. March 3, 1989.

Whether the "no exceptions" policy is continued is also of interest to the Congress because of its implications for national security and foreign policy. Proponents of the continuation of this policy argue that the Soviet invasion of Afghanistan was only one of several reasons for instituting it. Stephen Bryen, the former director of the Defense Technology Security Agency, recently argued that the Reagan Administration continued the "no exceptions" policy for strategic, rather than ideological, reasons.[8] A number of other arguments have been put forward by proponents of the current policy. For instance, some have argued that the policy should be changed only after consideration has been given to the full national security implications of such a change. Additionally, it has been noted that eliminating the "no exceptions" policy will not provide a vehicle for trade liberalization because exceptions list items never amounted to more than a fraction of the total value of CoCom trade with controlled countries.[9]

There are also some factors that would arguably support a reconsideration of the "no exceptions" policy. These include the Soviet withdrawal from Afghanistan, the improved relations between the United States and the Soviet Union, the reform program of Mikhall Gorbachev, and the improved human rights situation in the U.S.S.R. Pressure by other CoCom countries to end the "no exceptions" policy may also be a significant factor favoring reconsideration. Additionally, one industry group, the Computer and Communications Industry Association, has called for an end to the policy, arguing that the withdrawal from Afghanistan and improved U.S.Soviet relations "have called into ~~question~~ the validity of a policy that was couched in the terminology of national security controls, but was actually adopted largely for symbolic and punitive foreign policy reasons. . ." [10]

A recent Washington Post article noted that "several nations led by the British have for the first time since the Afghan invasion made formal application for approval of high-tech sales previously barred under the 'no exceptions' policy." [11] Another justification was provided by Under Secretary of Commerce Freedenberg: CoCom operates on the basis of consensus. That means that all members must agree on the level of technology to be controlled. It also means that any member who wants to approve the export of an item that exceeds the technological limits to bloc destinations, must get unanimous concurrence. This veto power is an extraordinary limitation on sovereignty. It is all the more remarkable since CoCom operates on an informal basis, without benefit of a treaty, or other formal instrument.[12]

Thus, in the event that the policy is revised, all significant sales of high technology goods would continue to require unanimous approval. Any sales that raised national security concerns would continue to be subject to a U.S. veto.

There has been some speculation that the "no exceptions" policy will be reconsidered during the Bush Administration's general review of strategic issues, which may be completed by mid-May 1988. According to the Washington Post, former Secretary of State George Shultz reportedly took the position that "unless there are persuasive grounds for retaining the Afghanrelated sanction [the "no exceptions" policy], it should be lifted for foreign policy reasons.[13] In another report, however, the Washington Post noted that Secretary of State James Baker, in an interview with Time, suggested "that future Soviet concessions beyond its Afghan withdrawal should be required before the Afghan sanctions are lifted. The article quoted Baker as saying, "Give away something unilaterally without a quid pro quo? . . . No

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[8] Bryen. Don't Sell High Tech to Moscow. New York Times. March 3, 1989. p. A39.

[9] One analysis of high-technology trade during the 1970's (the last decade in which reliable information is available) concludes: How numerous are exception requests and what is their usual fate? A 1978 report to the Congress stated that about one thousand exception cases valued at about $200 million were being submitted to CoCom annually and that the U.S. submits about half of these cases: Two to four percent of the requests were disapproved in CoCom, three to five percent withdrawn and many were revised to take into account changes recommended during the CoCom review process. During the 1970's the value of CoCom exception cases was running at a rate of less than one percent of total exports from CoCom countries to controlled destinations.
Hunt, Cecil. Multilateral Cooperation in Export Controls—The Role of CoCom. The University of Toledo Review. Vol. 14, No. 4 (Summer 1983). pp. 1285-1297.

[10] Bureau of National Affairs. "No-exceptions" Export Policy Toward Soviets Criticized by Industry Group. Daily Report for Executives. April 6, 1989. p. A18.

[11] Oberdorfer, Don. West Europe Challenges U.S. Trade Sanctions. Washington Post. February 7, 1989. p. A19.

[12] United States Congress. House. Committee on Foreign Affairs. Subcommittee on International Economic Policy and Trade. Statement by Dr. Paul Freedenberg, Undersecretary of Commerce for Export Administration. March 9, 1989.

[13] Oberdorfer, Don. Shultz, Carlucci Drew Battle Lines on Trade. Washington Post. January 26,1989. p. A22.

sir." [14] A debate over the continuation of the "no exceptions" policy is likely to take place within the Administration and within CoCom.

Reform of CoCom Procedures

Many of the problems inherent in national systems of export controls are also present in CoCom, the 16-nation multilateral organization that coordinates trade in strategic goods and technology. In spite of agreement on the overall objective of controlling strategic exports, differences among member countries have been a frequent and increasing source of tension. Many of the member countries have called for a relaxation of controls to correspond with the improvement in East-West relations. A recent British parliamentary report [15] provides an insight into some of the problems that individual countries have with CoCom. The British report appeared to ascribe some of the blame for the way in which CoCom functions to the United States, which can exercise veto power over license applications for strategic goods.

The report concluded that the multilateral export control system is in need of "immediate and radical" changes. These include sharp reductions in the scope and size of the CoCom list; a change in the rules and procedures to shift the burden of proof onto those objecting to an application instead of onto the country seeking approval to export; greater national discretion in the award of export licenses, and increased flexibility by CoCom in considering the end-use to which sensitive equipment is put; the number of technical restrictions should be reduced; and processing times for applications should be reduced.[16] Whether the British view is widely held by other CoCom members is unknown, but other CoCom member countries have expressed discontent with the CoCom process.

European Community Economic Cooperation by 1992

One of the objectives of the 1988 Omnibus Trade and Competitiveness Act (P.L. 100-418) is the creation of a license-free zone among CoCom and socalled "5(k)" countries—those countries that maintain cooperative export control agreements with the United States. The European Community's (EC) 1992 plan to create a single market out of 12 fragmented markets will, in effect, create a license-free zone for CoCom. Undersecretary of Commerce for Export Administration, Paul Freedenberg, has said that an EC without borders will mean a CoCom without borders.[17]

CoCom member countries have been strengthening national export control systems, and multilateral discussions aimed at strengthening foreign export control regimes have achieved considerable progress.[18] Nevertheless, the Secretary of Commerce reported to Congress in November 1988 that: Despite substantial effort in reviewing and analyzing much of the information available on foreign country control systems, a determination that any country has an export control system full in accordance with an effective level of protection cannot be made.[19]

The 1992 Plan may provide members of CoCom with an additional incentive to reach the goal of a license-free zone for high technology exports that Congress established in the 1988 Trade Act.

STATEMENT OF THE EXPORT-IMPORT BANK OF THE UNITED STATES

The Export-Import Bank of the United States is pleased to be represented at this workshop to discuss U.S.-Soviet commercial relations. The participants from the Bank are as follows: Dr. Daniel L. Bond, Vice President, Country Risk Analysis Division; Mr. Thomas E. Moran, Vice President, Europe and Canada Division; Mr. Ste-

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[14] Oberdorfer, Don. West Europe Challenges U.S. Trade Sanctions. Washington Post. February 7,1989. p. A19.

[14] United Kingdom. House of Commons. Trade and Industry Committee. Trade With Eastern Europe. House of Commons Paper No. 51. London: Her Majesty's Stationary Office. January 1989.

[16] This summary of the main conclusions of the British parliamentary report on the CoCom system relies on newspaper coverage of the report: Bureau of National Affairs, British Parliamentary Trade Committee Urges CoCom Reforms, Calls on U.S. to Ease Curbs. February 1, 1989. p. 142; Montagnon, Peter. UK MPs Urge Sharp Cut in CoCom Curbs. Financial Times. January 27, 1989. p. 5.

[17] Inside U.S. Trade. Undersecretary Sees Change in U.S. Export Control Policy Towards Soviets. March 24, 1989. pp. 9-10.

[18] U.S. Department of Commerce. Review of the Effectiveness of Export Control Systems Pursuant to Section 5(2) of the Export Administration Act of 1979 as Amended by Section 2415(a) of the Omnibus Trade and Competitiveness Act of 1988. November 1988.

[19] Ibid, p. 6.

phen G. Glazer, Associate General Counsel; and Mr. Frank Record, Congressional Relations Officer.

The Congressional Research Service has asked the Bank staff to provide answers to the following questions:

What has been Eximbank's experience in dealing with the Soviet Union?

What are the current legal restrictions on Eximbank lending to the Soviet Union?

How does the OECO Arrangement on Officially Supported Export Credits operate, and how does it affect the terms for official financing of trade with the U.S.S.R.?

What are the current levels of activity of other official export credit agencies in financing trade with the Soviet Union?

What would be the likely response of U.S. exporters and bankers if current restrictions on Eximbank financing of exports to the Soviet Union were lifted?

EXIMBANK'S EXPERIENCE IN DEALING WITH THE SOVIET UNION

Eximbank has a long history of dealings with the Soviet Union. Soon after President Franklin Roosevelt granted the Soviet government official recognition in 1933, he established the first Export-Import Bank for the specific purpose of extending credit to the U.S.S.R. so that it could import industrial equipment and other products from the United States. No loans were made at this time because of the lack of a settlement on prel- revolutionary Russian debts to the U.S. government.[1]

Immediately following World War II, Eximbank was once again prepared to provide the Soviets with financing for imports of U.S. goods. However, no loans were made at this time. A dispute arose over payments on the U.S.S.R.'s Lend-Lease debt to the United States. Another problem was the Soviet government's 'refusal to provide economic and financial information required by Eximbank.

Once the Cold War began, the U.S. government established various restrictions on U.S. exports to communist countries. However, it was not until 1964 that Congress enacted the first direct prohibition on Eximbank financing for trade with the Soviet Union in the Foreign Assistance and Related Agencies Appropriations Act of that year. In 1968 Congress amended the Export-Import Bank Act of 1945, giving the President authority to grant credits, guarantees and insurance to communist countries if he made a determination that it was in the national interest to do so. However, another amendment was added that restricted Eximbank from involvement in transactions with countries supporting nations engaged in armed conflict with the U.S. The law applied to the Soviet Union at this time since it was providing assistance to North Vietnam.

The Export Expansion Finance Act of 1971 modified all previous Eximbank Act restrictions on transactions with communist countries by adding a provision that allowed the President to issue a waiver for communist countries not engaged in armed conflict with the United States if he determined that it would be in the national interest to do so. President Nixon issued such a waiver for the U.S.S.R. on October 18, 1972. The same day Eximbank and Soviet officials signed an operating agreement setting forth procedures for Eximbank to provide credits to the Soviet Bank for Foreign Trade (Vneshtorgbank). Immediately afterwards, the Soviet Union filed its first loan application.

The first Eximbank credit to the U.S.S.R. was approved February 21, 1973 when the Bank made a loan of $11,672,000 to the Soviet Bank for Foreign Trade (Vneshtorgbank) for the export of $26 million worth of submersible oil-field pumps. The loan was guaranteed by the Soviet Ministry of Foreign Trade acting on behalf of the Soviet government. Over the next IS months Eximbank made an additional IS loans to Vneshtorgbank, all of which were guaranteed by the Soviet Ministry of Foreign Trade. In total, $469 million in loans were made to finance over $1 billion in U.S. exports. The total term of these loans was from 7 to 17 years, carrying a fixed interest rate of 6%.

A major concern at Eximbank during this period was the unwillingness of the Soviets to provide adequate financial and economic information. The Bank made several requests for information, but all were ignored. Although the Soviet government guaranteed all credits and was considered to have a good repayment record, the Bank staff became increasingly concerned as the level of total Soviet indebtedness

[1] The Kerensky Provisional Russian Government of 1917 borrowed $192.6 million from the U.S. government to help finance its military operations during World War I. These debts were repudiated by the new Soviet regime when it came into power. The Johnson Debt Default Act of 1934 made it unlawful for any person to make any loan to a foreign government, while that government is in default in the payment of its obligations to the U.S. government. However, in 1945, with the enactment of the Export-Import Bank Act, transactions in which the Eximbank participated were exempted from the provisions of the Johnson Act.

rapidly increased. Finally, the Bank imposed an informal ceiling of $500 million of total exposure until adequate information was made available to allow a better evaluation of the Soviet Union's creditworthiness.

On January 3, 1975 the Trade Act of 1974 was signed by President Gerald Ford. The Jackson-Vanik Amendment to this Act prohibited the granting of nondiscriminatory tariff treatment—often referred to as most-favored-nation status—and the provision of U.S. government credits to any nonmarket-economy country which restricts the emigration of its citizens. A provision was included which allowed for a Presidential waiver if an affected country provided assurances that it would improve its emigration practices. The Soviet government refused to accept an explicit linkage between emigration and trade, and did not offer the assurances required by the Jackson-Vanik Amendment. As a result, since January 3, 1975 Eximbank has been unable to provide any further financing for U.S. exports to the Soviet Union.

The record of the U.S.S.R. in repaying its indebtedness to Eximbank has been impeccable. Eximbank have been fully repaid on 14 of the loans it made, and only $72.3 million remains to be paid on the remaining two loans. The final payment date on one of these is April 19, 1989; on the other it is in November 1990. In addition to the loan principal, interest and fees totaling some $284 million have been paid to Eximbank by the Soviet Union during the period since the loans were authorized.

CURRENT RESTRICTIONS ON THE FINANCING OF U.S.-SOVIET TRADE

The key legal restraints on the financing of U.S.-Soviet trade are the Jackson-Vanik and Byrd Amendments in the Trade Act of 1974, and the Stevenson Amendment and the prohibition on financing exports to Marxist-Leninist countries in the Export-Import Bank Act of 1945.

Jackson-Vanik Restrictions

The Jackson-Vanik Amendment specifies that a "nonmarket-economy country" shall not: be eligible for nondiscriminatory tariff treatment (often referred to as most-favored-nation or MFN treatment);[2] receive U.S. government credits, credit guarantees or investment guarantees;[3] or conclude a commercial agreement with the United States.

If the government of that country: denies its citizens the right or opportunity to emigrate; imposes more than a nominal tax on emigration or on the visas or other documents required for emigration, for any purpose or cause whatsoever; or imposes more than a nominal tax, levy, fine, fee, or other charge on any citizen as a consequence of the desire of such citizen to emigrate to the country of his choice.

The President has the authority to lift these restrictions on trade, credits and guarantees to individual countries if he determines that the country is no longer in violation of the above three conditions. Moreover, before the restrictions are actually lifted, the President is required to submit to Congress a report including "information as to the nature and implementation of emigration laws and policies and restrictions or discrimination applied to or against persons wishing to emigrate."

Under Jackson-Vanik, the President was also authorized to waive by Executive Order for an initial 18-month period the application 'of the provisions if he determined that such a waiver would substantially promote the human rights objectives of the Act and he had received assurances that the country's emigration practices wood improve. If the President elected this second route, the waiver authority could be extended for consecutive 12- month periods thereafter by submitting to Congress a document supporting his request each year. Depending on the particular time period, various legislative procedures are provided for Congress to approve or block the extension of the waiver authority with respect to individual countries. At this

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[2] Nondiscriminatory tariff treatment is a fundamental component of our international trading system. The United States has granted such treatment to nearly all of our trading partners around the world and is granted the same in return. With only a few exceptions, the United States is the only country which denies nondiscriminatory treatment to other countries, and we do it only with respect to certain nonmarket-economy countries.

[3] The United States provides official export credits primarily to allow U.S. exporters to compete with officially financed exports from other countries. Guarantees and insurance are provided where similar coverage cannot be obtained in the private market at a reasonable cost. The United States is practically the only country which denies export credit to nonmarket-economy countries on other than financial grounds. The Jackson-Vanik restrictions apply to the financing programs of the Export-Import Bank (including the insurance programs of the privately run Foreign Credit Insurance Association, which acts as Eximbank's agent to provide export credit insurance), the Small Business Administration, the Commodity Credit Corporation, and the Overseas Private Investment Corporation.

time, if the President decides to extend the waiver authority to the Soviet Union, Congress will have the opportunity by a resolution of either house to disapprove such extension within the 60-day period following the most recent 12-month period.[4]

The President has never determined that a country is not in violation of the three emigration conditions set forth in Jackson-Vanik. Instead, the President has chosen to waive the application of Jackson-Vanik for the initial 18-month period and then to extend the waiver authority with respect to certain countries for consecutive 12-month periods. This has been done for Hungary, China and Romania (through 1988). Poland and Yugoslavia were statutorily exempted by Jackson-Vanik. It should also be noted that Congress has never approved or blocked the extension of the waiver authority with respect to any country.

The Stevenson Amendment

The Stevenson amendment to the Eximbank Act sets a ceiling of $300 million on the aggregate amount of new Eximbank exposure to the U.S.S.R. that could be incurred following the date of enactment of the amendment (January 4, 1975). This would not include any of the $469 million lent by the Bank during 1973–74. The amendment also specifies that no loan or financial guarantee shall be used for the financing products or services which would increase the production, processing or distribution of any Soviet fossil fuel resources, and places a limit of $40 million on financing of exports supporting research or exploration of Soviet fossil fuel energy resources.

The Stevenson amendment also provides a procedure for lifting the ceiling on future credits to the Soviet Union. The President can recommend a higher overall exposure limit and a higher ceiling on credits for fuel research and exploration by reporting to Congress that this would be in the national interest. For the recommendation to go into effect, Congress must then approve it by means of a concurrent resolution.

Finally, Congressional notification is required for any transaction involving Eximbank financing of $25 million or more for the export of goods or services involving research, exploration or production of fossil fuel energy resources in the Soviet Union.

The Byrd Amendment

The Byrd amendment to the Trade Act of 1974 is similar to the Stevenson amendment and states that no agency of the U.S. government except the Commodity Credit Corporation, shall approve any loans, guarantees, insurance or any combination thereof, in connection with exports to the U.S.S.R. in an aggregate amount in excess of $300 million without prior Congressional approval. The ceiling refers to exposure incurred after the passage of this legislation (January 3, 1975).

No procedure for lifting the ceiling is contained in the Byrd amendment; instead, it would have to be amended or repealed by Congress.

Restrictions on Marxist-Leninist Countries

Section 2(b)(2) of the Export-Import Bank Act specifies that the Bank shall not guarantee, insure, extend credit, or participate in the extension of credit in connection with exports to a Marxist-Leninist country, and specifically includes the Soviet Union in this category. This section, which was added in 1986, replaces an earlier section which contained similar prohibitions on support of 'U.S. exports to "communist countries." The President is given the authority to grant a waiver if he determines that the extension of financing is in the national interest and reports the determination to Congress. Since President Nixon made such a determination on October 18, 1972, a new determination may not be necessary.

This section of the Eximbank Act also specifies that the President shall make a separate national interest determination for each transaction for which the Bank would extend a loan in an amount of $50 million or more, provided that the determination is also notified to Congress.

THE OECD ARRANGEMENT ON OFFICIALLY SUPPORTED EXPORT CREDITS

The loans made by the Eximbank to the Soviet Union in 1973 and 1974 carried the Bank's then prevailing fixed interest rate of 6o per annum. This rate was set by the Bank globally with a view toward the terms of official financing being offered by other industrial countries. However, this rate was approximately one to three

[4] It should be noted that such an action may be of doubtful constitutionality and, in fact, there are constitutional concerns about the validity of the whole Jackson-Vanik waiver procedure.

percentage points below long-term market rates at that time, and therefore entailed a significant degree of subsidization by the U.S. government.

Since the early 1960's the United States has been opposed to the practice—widespread among industrialized countries—of using government subsidized financing to promote exports. However, it was not until the early 1970's, when the level of subsidization increased sharply as market rates began to rise, that most other Western governments recognized the need for a multilateral agreement to control this practice. In 1976 such an agreement was reached among six export credit agencies. The agreement was formalized in 1978 and expanded to include export credit agencies from 20 countries. Currently, agencies from 22 countries are involved. (Iceland and Turkey are the only OECD members not participating.) The agreement is officially known as the Arrangement on Guidelines for Officially Supported Export Credits. It is administered by the Secretariat of the Organization for Economic Cooperation and Development (OECD), located in Paris.

Under the Guidelines minimum interest rates and terms are set for officially financed or subsidized export credits of two years or more.[5] The rates differ by category of country, from Category I (rich countries) to Category III (poor countries), with the more generous terms being provided the poorer countries. In 1976 the U.S.S.R. was placed in Category II (intermediate countries), where it still enjoyed some subsidization of interest rates. But in July 1982 it was reclassified to Category I.

It has been the intention of the participants in the Arrangement that interest rates on loans to category I countries correspond to market rates. Initially, because the minimum interest rates were adjusted infrequently, they sometimes deviated from market rates rather substantially. A major revision was made in 1983 when a formula was established for automatic semiannual changes in the minimum interest rate. Finally, in mid-1988, the participants in the OECD Arrangement agreed that interest rates on loans to Category I countries be set at the market rate of interest charged in the various members' currencies for fixed rate loans to first class borrowers. Such rates are called Commercial Interest Reference Rates (CIRR's). A system was established for determining these rates and for adjusting them on a monthly basis. As a result of these developments, the degree of subsidization in official financing of exports to Category I countries h6as been greatly red ıced—if not completely eliminated.[6]

The changes in the Arrangement over the past decade have affected the degree of subsidization that would have been involved in U.S. lending to the Soviet Union over the last decade. In this figure two interest rates are shown: the minimum interest rate allowed under the Arrangement on U.S. dollar loans of five years or more to the Soviet Union; and the average interest rate of commercial loans to the Soviet Union arranged through Eurodollar syndications.

The minimum interest rate that would have applied to official lending to the Soviet Union for a term of 5 to 10 years. The commercial rates would have been for comparable loans.[7]

Until 1983, interest rates on officially supported export credits were clearly well below commercial loan rates, by as much as percentage points. But afterwards, as the minimum rate allowed under the Arrangement was raised and commercial rates dropped, the relationship was reversed.[8] This indicates that the potential for direct interest rate subsidies to the Soviet Union from official loans have largely been eliminated. This will likely continue to be the case in the future since the minimum Consensus rate is now tie very closely to the market rate.

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[5] The Arrangement does not cover financing for exports of military equipment or agricultural commodities.

[6] The OECD Arrangement also specifies a maximum repayment term on loans for category I countries. This is not to exceed five years, except after prior notification to other export credit agencies, when a term of up to eight and a half years can be offered.

It is Eximbank policy to support long-term (over five years) transactions for Category I countries with guarantees only. Medium-term (two to five years) transactions for Category I countries can receive loans at CIRR.

[7] The commercial rates shown in the figure are equal to the three-month London Interbank Offer Rate (LIBOR), plus an average margin over LIBOR used in syndicated credits to the USSR and Eastern Europe as estimated by the OECD and a second adjustment representing the difference between short- and long-term interest rates.

[8] One indication that Figure 1 correctly reflects changes in the degree of interest rate subsidization is the fact that the Soviets reduced their use of official credits during the mid1980's and switched to syndicated commercial bank loans.

Official Financing of Exports to the U.S.S.R. by other Governments

Except for the U. S., all the major western governments provide export financing for their countries' exports to the Soviet Union. The nominal dollar value of their total commitments (either in the form of loans or guarantees, including current exposure plus committed but undisbursed funds and future interest payments) to the Soviet Union reached a peak in 1982. In that year the level of these commitments exceeded $22 billion. West Germany had the largest level of commitments, followed by Japan, France, Italy and the United Kingdom. Since 1982, the value of total commitments has been in decline, and stood at slightly less than $16 billion in September 1988. Japan's share in the total has been rising, and although the nominal value of its commitments are slightly less than in 1982, Japan now has the largest amount, and Germany has moved to second place.

In 1983, the Soviet Union began to shift its borrowing from official sources to syndicated credits and international bond issues. The trend away from official export credits seems to reflect the relative competitiveness of the commercial banks at a time when Consensus rates were on the rise.

Official export credits to the Soviet Union are likely to increase again in the future for several reasons. As the OECD notes, "with rising unguaranteed exposure as a result of Soviet pressures to resist guaranteed credits when cheaper finance was available in the private market, banks' willingness to allow exposure to the U.S.S.R. to rise without adequate compensation has diminished." In other words, the U.S.S.R. will need either to obtain government guarantees on its loans or pay higher interest rates.

Furthermore, a number of countries are eager to take advantage of the Soviet economic reforms through increased export sales. Last year, several West European export credit agencies negotiated framework agreements for substantial trade credits to the Soviet Union. Thus, the downward trend in activity seen since 1984 seems to have bottomed out in 1988 and may well reverse itself this year.

As a result of Eximbank's contacts with other official export credit agencies, the Bank's staff is made aware of specific financing proposals made or under consideration by European and Japanese agencies in support of exports to the U.S.S.R. from firms in their respective countries. Recent proposed transactions relate to all types of projects—exports of entire plants for the manufacture of breakfast cereals and shoes, projects for hotels and dairies, and exports of rubbish incinerators. The exports involved in some instances have amounted to several hundred million dollars.

Projected Impact on U.S. Trade of Removing Restrictions on Eximbank Financing of Exports to the Soviet Union

Eximbank staff have not attempted to make any quantitative projections of the increase in U.S. exports that would result if restrictions on Eximbank financing of exports to the Soviet Union were lifted. The demand for Eximbank financing would depend, in part, on the forms of assistance made available and their specific terms. For Category I countries the Bank normally offers: export credit insurance through the Eximbank's agent, the Foreign Credit Insurance Association (FCIA); working capital guarantees which help small companies obtain pre-export financing from commercial lenders; guarantees for private loans covering up to 85% of the U.S. export value, with repayment terms of one year or more; and direct loans at CIRR—but only in cases where there is foreign competition which is receiving subsidized official export credits.

Based on the Bank's evaluation of the country's creditworthiness, it also establishes an exposure fee (which is a percentage of the value of Bank's financial coverage and varies in accordance with the perceived risk of repayment) as well as specific limitations on the Bank's programs in a given country.

In evaluating the creditworthiness of the Soviet Union, it is likely that the Bank will, once again, discuss with the Soviet authorities the need for improved disclosure of their economic and financial condition. Although the Soviet-government has begun to be more open about certain aspects of their economy, they still provide almost no information on either their convertible currency trade, foreign assets and liabilities, or reserves. While an assessment of Soviet creditworthiness can be made on the basis of western estimates, the uncertainty inherent in this approach will likely increase the perception of risk and result in higher exposure fees being placed on Eximbank transactions with the Soviet Union.[9]

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[9] The Soviet government has recently indicated to western export credit agencies that they are not prepared to have the Vriesheconomhank (the successor organization to the Vneshtorg-

Continued

PREPARED STATEMENT OF JUDY SHELTON

MAKING SENSE OF GORBACHEV—AN ECONOMIC AND FINANCIAL PERSPECTIVE

When the subject of East-West trade is discussed in political circles—most particularly, the issue of Soviet borrowing—the talk often turns to such matters as human rights, regional conflicts, or arms control. Indeed, purely financial questions about the Soviet Union's internal budget crisis and its creditworthiness as a borrower tend to be downplayed in the broader debate over East-West political relations.

This is unfortunate; it may well prove dangerously shortsighted for members of the Western Alliance. Understanding the budgetary pressures facing the Kremlin at this time is key is- we are to understand Soviet motives in world affairs. Only by comprehending the magnitude of the financial and economic problems now confronting Moscow do we gain proper perspective for interpreting Soviet global behavior, and specifically, Gorbachev's political initiatives toward the West.

Internal Economic Stresses

One can draw a rough linkage to identify the connection between chronic budgetary shortfalls and resulting economic and political fallout. The Soviet domestic budget, i.e., the internal state budget, regulates the monetary and financial system in the Soviet Union. The distribution of internal resources is directly affected by the amount of credit within the Soviet system, and thus is vulnerable to the consequences of monetary distortions caused by having to cover internal budgetary deficiencies.

In other words, budget problems lead to credit and financial problems, and financial problems bring about bottlenecks that impede the efficiency of production. Moreover, monetary distortions make it difficult for central planners to evaluate the viability of enterprises, and they inhibit the use of pay incentives as a means of increasing the productivity of workers. In general, monetary and financial problems in the Soviet Union greatly exacerbate the already serious underlying economic problems.

When economic difficulties reach the point of severity where citizens feel stressed due to, say, widespread consumer shortages, the situation can lead to social turmoil. Anti-social behavior in the Soviet Union is already observable in the form of widespread corruption and black market activities; it may well be manifested in the future as mass strikes by workers. Social turmoil is generally the precursor to political upheaval, which unfortunately is often accompanied by violence. Should conditions in the Soviet Union reach the point where widespread violence was eminent, it would be socially and politically destabilizing.

Much is at stake, then, for members of the Western Alliance as well as Gorbachev, and it is therefore of vital importance to fully grasp the nature of the internal financial and economic crisis in the Soviet Union.

Budget Deficit

At the heart of the problem is the internal budget deficit. To put it in the most straightforward terms: The Soviet government is currently running a massive budget deficit and, 'despite assertions to the contrary, has been for years.

In the United States, of course, we have become all too aware of the implications of budget deficits. Our own domestic budget deficit constantly looms before us as the constraint that prevents our spending as much as we might like on both social programs and defense needs.

There are, however, some rather clear distinctions between the United States and the Soviet Union in terms of the effects of running budget deficits. Consider that only about 20 percent of U.S. gross national product is represented in the domestic budget. In the Soviet Union, more than half of the national income flows through the budget. Thus, if we believe that budgetary imbalances in the United States foretell difficulties dawn the road for the U.S. domestic economy, it follows that revenue shortfalls in the Soviet internal budget carry much more ominous implications for the future of the Soviet economy.

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bank) offer governmer . guarantees on all official credits, as has been the practice in the past. Only those purchases regarded as of national importance would receive such state guarantees. Soviet ministries, foreign trade organizations, and enterprises are now being told to obtain financing on their own. If such a policy is implemented, this will make it more difficult for Eximbank to find reasonable assurance of repayment on individual cases. At a minimum, Eximbank will need more detailed fina cial and economic information at both the country and enterprise levels.

Up until late October 1988, the Soviet Union never provided an indication that, it was experiencing budgetary problems of any sort. In fact, the official statistics published by the Soviet government state that a budget surplus has been achieved every single year since 1944, including the most recent figures published for 1987. The idea of a balanced budget is part of the very doctrine of socialism; it serves as a testimonial to the wisdom of central planning.

It was therefore no less than a startling disclosure when, some five months ago, Soviet Finance Minister Boris Gostev told an assembly of the Supreme Soviet that the 1989 budget would show a 36 billion ruble deficit (about $58 billion), over 7 percent of the total state budget. Even more shocking, Gostev revealed that the problem of deficits had not bust now emerged, but had been going on for years.

For the Soviet Union to admit to a budget deficit, given that it has always held up the U.S. budget deficit with its attendant scourge of inflation as the ultimate symbol of capitalist mismanagement, is a radical shift indeed. It was prompted, it would seem, by the sheer desperation of the Soviet financial situation. Strongly reinforcing that conclusion, Leonid Abalkin, one of Gorbachev's closest economic advisors, made the statement in January that the actual Soviet budget deficit is three times higher than the figure admitted by the Finance Minister last October; according to Abalkin, the deficit amount for 1989 is over 100 billion rubles.

To put that in perspective: The U.S. budget deficit is roughly 3 to 4 percent of gross national product. The original deficit figure cited by Gostev would have put the Soviet deficit at a comparable level of 3.9 percent of gross national product. However, the revised figure for the Soviet budget deficit revealed by Abalkin and subsequently corroborated by Abel Aganbegyan, another leading economic advisor to Gorbachev, represents some 11 percent of Soviet gross national product. (My own calculations indicate that the actual amount of the Soviet budget deficit arising from domestic economic activities is closer to 18 percent of gross national product, and that revenues from foreign imports play a substantial, though as yet unacknowledged, role in setting the nominal deficit amount.)

Obviously, many countries are carrying a budget deficit, including, of course, the United States. But when it comes to financing the deficit—and all governments must finance their revenue shortfalls, either internally or by borrowing from abroad—the Soviet Union has a considerable problem. Among major industrial nations, the Soviet Union's problem is rather unique: Its currency is not convertible. One can only use rubles to buy Soviet-produced goods. So whereas the United States can get investors in other countries to finance its deficit directly because they are willing to hold dollar-denominated bonds, the Soviet Union does not have this option. It must bear the entire impact of financing its deficit internally. And deficit spending, whether in a capitalist system or a socialist one, spawns inflationary pressures.

Productivity Conundrum

In the United States and other Western countries, the term inflation is considered practically synonymous with the idea of rising prices. Under free markets, when there is too much money in the system, the prices of goods rise to accommodate the excess money in the hands of consumers. But in the Soviet Union, prices are fixed by the government. Inflation is therefore manifested differently.

Soviet consumers today are holding too many rubles because, over the last two decades, wages overall have been increased' through the inflationary practices of the Soviet government. With all these extra rubles, however, they can hardly buy anything; at the fixed prices, all available consumer goods tend to sell out immediately. In other words, wages have been increased in the Soviet Union without there having been a concurrent 'increase in productivity. The additional rubles that have been printed are now chasing the same basic level of goods as before. Inflation under socialism, therefore, does not result in higher prices, but rather shows up in the form of longer lines.

In addition to the observed consumer shortages and black market activities, there exists another telling symptom of severe inflation in the Soviet economy. Since 1970, there has been a monumental build-up in the savings accounts of the Soviet population. While this would constitute a healthy development in a free market economy, it is a bad sign taking place in a fixed price regime inundated with excess currency.

In the Soviet Union, citizens do not have many choices about where to invest their earnings; they either spend them or they put them in the state-run savings banks. Thus when wages cannot be spent because goods are unavailable, the money begins to accumulate in the savings banks, paying 2 to 3 percent interest. The total savings deposits of the Soviet population have increased more than six-fold in the

last two decades, rising from 47 billion rubles in 1970 to more than 300 billion rubles currently. During the same period, reported Soviet budget revenues increased by less than three-fold.

To reiterate the problem: There are significant and chronic revenue shortfalls in the state budget; the Soviet government has been running an enormous budget deficit; the government finances this deficit internally by printing excess money. How is this excess money actually infused into the Soviet system? It is generally accomplished through the state-owned enterprises, which, whether they are productive or not, are required to contribute certain amounts to the state budget out of their so-called "profits."

When a Soviet firm has not earned sufficient money to make its requisite payment back to the state budget, i.e., to the Soviet government, it looks to the state-owned banking system to provide the necessary funds. The deposit accounts of Soviet enterprises are administered by the State Bank (Gosydarstvennyi Bank or Gosbank), the same state bank that also takes in the deposits of the people. Gosbank traditionally has been empowered not only to handle all financial transactions, but also to have supervisory authority over the operations of enterprises. Such a mandate carries with it an inherent responsibility for the performance of the enterprises—and therein lies a serious conflict of interest.

If an enterprise fails to make its required payment to the government, it casts a very bad reflection on the officials at Gosbank. Rather than incur the scrutiny of government authorities in higher positions, Gosbank officials have found it altogether too tempting to simply make the funds available to unprofitable enterprises out of which payments to the state budget can then be advanced.

Since Gosbank is owned and administered by the state, the mechanical granting of credits means that the Soviet government is making loans to itself to make up for inadequate revenues from production at state-owned enterprises. In the financial statements prepared by the Central Statistical Administration, unwarranted credits masquerade as phantom contributions to the budget; they are buried under accounting entries such as "deductions from profits and other payments" and carried as budget revenues in the official published statistics.

Now that leading Soviet economists are going public about the existence of deficits and other budgetary misrepresentations, perhaps there will be pressure to replace the deceptive accounting practices with more straightforward techniques in the future. Such an outcome, naturally, falls within the prerogative of Gorbachev and the TsSU.

How the West Fits In

The Soviet budget crisis is essentially an internal financial problem. Due to chronic revenue shortfalls, the Soviet government is tightly constrained in its spending at this point; if Kremlin officials want to spend additional money on consumers, or on fixed capital investment, or on the military sector (not necessarily in that order), they need first to increase the productivity of the Soviet economy to extract additional real revenues.

But there are only two methods, according to classic economic theory, for improving productivity. The first is to increase the productivity of labor, the second is to increase the productivity of capital. Increasing the productivity of labor is accomplished by getting people to work harder or longer; it is conventionally achieved by offering to pay them more money for their extra effort.

Herein lies the primary component of the internal economic dilemma Gorbachev is facing. Because of the inflationary consequences of financing an internal deficit, Soviet workers already have too much worthless money that is virtually inconvertible, even within Soviet borders, into desired consumer goods. And offer them with more money as the reward for additional work carries little incentive appeal. It is necessary to have the consumer goods in place first if people are to be persuaded to work harder to earn the money to buy them. yet, until Soviet workers start working harder, it is unlikely that significantly higher levels of consumer goods can be produced in the Soviet Union. Thus, when it comes to improving soviet labor productivity, there exists a catch-22 situation.

The other path, which calls for increasing the productivity of capital, requires the application of technology to improve existing production methods. Technological breakthroughs are normally achieved through research and development efforts; these tend to be costly and time-consuming. Investment in research and development is not something the Soviet government can well afford at this time. (While Moscow has spent considerable sums for A & D related to military application, it has neglected to devote sufficient amounts to improving manufacturing techniques in the consumption sector.)

Perhaps even more pertinent than the costliness of such research and development programs is the timing factor; Soviet citizens are growing increasingly restless about the lack of available consumer goods. They want improved production and greater supplies today. In promising higher levels of consumer goods to his people, Gorbachev cannot help noticing that the state-of-the-art equipment and technology capable of dramatically improving Soviet productivity already exists in the West.

In short, the two inputs the Soviet system needs to break out of its financial and economic conundrum—consumer goods to motivate workers, technology to increase productivity—must come from outside the Soviet Union. If the West does not furnish them, Gorbachev (or his replacement) will be forced to make a fundamental and wrenching change within the Soviet system to transfer resources out of the military sector, which is basically unproductive, and into manufacturing for the consumption sector, which is the source of real economic production. The alternative is to permit the Soviet economy as a whole to continue to deteriorate, and, in so doing, incur the grave risk of social and political unrest.

In light of this analysis, it becomes apparent that deliveries from the West of consumer goods and technology, financed with Western credits, have the effect of relieving the pressure on the Kremlin to implement a decision to divert resources from producing guns to producing butter. If we in the West take it upon ourselves to supply the consumer goods for the Soviets, and make available to them the benefits of our own research and development by furnishing the technology outright, we effectively grant the Kremlin a reprieve.

Assistance from the outside serves to alleviate the internal economic pressure that is the compelling force behind perestroika; it enables Soviet authorities to continue to devote scarce internal resources to the military as before. Thus, aid from the West has the effect of forestalling the very transition process we presumably would like to see taking place in the Soviet Union: a switch in priorities from military spending to improving the quality of life for the Soviet people.

We are witnessing a crucial period in the existence of the Soviet Union, observing a make-or-break situation in the Kremlin, and what the West does now may have a pivotal impact in determining the viability of the Soviet status quo. No doubt this is why we are witnessing such extraordinary exports being made by Gorbachev to appeal to the most preeminent concerns of members of the Western Alliance.

Clearly, Gorbachev is dealing his best cards: unilateral arms reductions, increased emigration, withdrawal from Afghanistan. All of these should be seen as reflections of the desperate financial situation in the Soviet Union. By understanding that, we maintain an informed perspective for evaluating proposed political arrangements whereby economic rewards and trade benefits from the West are exchanged for specific concessions by the Kremlin.

What is important to keep in mind is that any such deals are no tribute to Western diplomacy; they are being driven from the Soviet side. It is Gorbachev who, by holding out the possibility of reduced military tensions and Soviet improvement on human rights as bait, is coercing the West into providing the desperately needed financial help.

Prepared Statement of Sumner Benson

HOW TECHNOLOGY TRANSFER SHAPES THE UNITED STATES-SOVIET STRATEGIC RELATIONSHIP

SUMMARY

United States policy on the transfer of high technology can affect decisively the overall strategic relationship with the Soviet Union. This is true because many critical "dual use" technologies have important military as well as civilian applications. U.S. and allied governments maintain national security export controls to protect the Western lead in strategic technology that is needed to offset the numerical advantages of the USSR and Warsaw Pact.

Recent experience shows that such controls must remain an integral part of Western security policy until the Soviet Union makes historic and permanent changes in its military posture. During the detente of the 1970's, the United States and its allies loosened controls on dual-use technologies in the hope that an expanding East-West trade would weaken the Soviet military-heavy industry complex. Instead, access to Western high technology sharpened the edge of the Soviet military buildup. In the 1980's, Congress and the Administration worked together to revitalize the export control system. That effort helped to restore U.S. military strength, and indirectly to bring the Soviet Union back to the nuclear arms negotiating table.

To build on these successes in the 1990's, the United States and its allies must use strategic trade controls to constrain the Soviet military and to bolster Western initiatives in defense and arms control. We do not yet know to what extent the Soviet military will move away from the offense-oriented strategy and force structure of the Brezhnev era. We also do not know how much, or even whether, perestroika will reduce the present high level of Soviet military spending. These uncertainties require that the West be cautious about exporting technology that could strengthen Soviet military capabilities.

A second reason to protect key advanced technologies is that they are critical to the modernization of NATO's conventional forces. If the Soviet military gained access to these technologies, it could more easily neutralize improvements in Western defenses. Finally, a Western technology edge will increase the chances for successful arms control negotiations by giving the Soviet Union a further incentive to reduce its forces and by helping preserve an effective U.S. nuclear deterrent with a smaller number of weapons.

I. WHY THE WEST REGULATES STRATEGIC TRADE

The transfer of dual-use technologies—those with both civilian and military applications—differs from most issues in U.S.-USSR commercial relations. The United States considers the export of these technologies to the Soviet bloc to be "strategic" trade and approaches such exports from the standpoint of military security rather than of international commerce.

The military importance of many primarily civilian technologies is well recognized. For example, in 1976 a Defense Science Board study pinpointed the potential military costs of exporting commercial computers. This, the so-called Bucy report, stated that the "mere presence" of large computer installations "transfers know-how in software" and "develops trained programmers, technicians and other computer personnel" All of this' can be "redirected to strategic applications." [1] In 1982 William. Perry, who served President Carter as Under Secretary of Defense for Research and Engineering, noted that the technologies of microelectronics and computers were developed "primarily for commercial applications" but have had a major military impact. In Perry's view, these technologies have shifted the focus of military planning from "delivery vehicles and explosive devices" to "improvements in sensors, control and accuracy." [2]

Dual-use technologies are central to U.S. and Western defense. Since the founding of NATO, the United States and its allies have counted on superior economic productivity and technological innovation (together with nuclear weapons) to offset the Warsaw Pact numerical lead over NATO in conventional forces. In May 1989, in the area from the Atlantic to the Urals, that lead is roughly 3-to-1 in tanks and artillery, 5-to-1 in armored infantry fighting vehicles, and 2-to-1 in combat aircraft. The Western nations continually have sought improvements in defense-related science and technology through support of basic research at laboratories and universities, reliance on the competitive forces at work in private enterprise, and selected sharing of technology by way of cooperative projects for weapons development and production.

To be effective, technology development and cooperation within the West must be reinforced by technology security with respect to the East. It does the United States little good to outpace the Soviet Union in research and development (R&D) and production capabilities if the Soviets are able to acquire the fruits of our efforts and use these to improve their weapons.

That is why the United States maintains a selective embargo on goods and technologies that would strengthen the USSR and Warsaw Pact militarily. The Export Administration Act of 1985 (updating legislation of 1949, 1969 and 1979) authorizes controls over goods and technologies that would make a "significant contribution to the military potential of any other country or combination of countries which would prove detrimental to the national security of the United States." [3] The control list prohibits or regulates export of a wide range of dual-use goods such as advanced computers, industrial robots, computer software and sophisticated telecommunications switching equipment.

The United States works with its allies through COCOM, the Coordinating Committee for Multilateral Export Controls, which was established in Paris in 1950. COCOM developed parallel to NATO as part of the overall system of post-World War II Western collective security. It now includes almost all members of NATO (all except Iceland), plus Japan and Australia (the latter having joined in 1989).[4]

II. RELAXATION OF STRATEGIC TRADE CONTROLS IN THE 1970'S

Recent experience shows how technology transfer can change the military balance between the United States and the Soviet Union. During the detente of the 1970's, COCOM and individual Western nations loosened controls on dual-use technologies. U.S. and West European political leaders hoped that an expanding East-West trade would strengthen those groups in Soviet politics associated with consumer goods and foreign trade and, in so doing, weaken the military-heavy industry complex.

These hopes were misplaced. Instead, increased trade between East and West contributed to a major, across-the-board modernization of Soviet nuclear and conventional forces; it thereby helped fortify the position of the Soviet military establishment. We now know that by the early 1980's, the USSR was acquiring annually from the West (legally and illegally) about 6,000 to 10,000 pieces of hardware and more than 100,000 technical documents. Much of this technology (in fields such as computers, microelectronics and composite materials) was developed by, and has been applied primarily to, the civilian sector in the West. Such acquisitions helped strengthen Soviet military capabilities. According to Soviet estimates, in the early 1980's an average of more than 5,000 military projects benefited each year from Western hardware and documents. For example, Western technology greatly improved Soviet tanks, fighter and ground attack aircraft, artillery fuzes and shells, and submarines and surface warships. It also aided electronic and microelectronic systems as well as radars and computers that support military operations.[5]

A dramatic example of how strategic technology can be lost was the illegal sale (in violation of COCOM commitments) by European and Japanese companies of propeller manufacturing technology to the Soviet Navy. This transfer of technology helped make Soviet submarines quieter and hence better able to avoid detection by U.S. and allied anti-submarine forces.

III. REVITALIZATION OF TECHNOLOGY SECURITY IN THE 1980'S

To stop or slow such losses, Congress and the Administration essentially rebuilt the U.S. technology security system. The Reagan Administration (building on initiatives of the last year of the Carter Administration) increased both the responsibilities and the resources of the Department of Defense. The Administration also strengthened the importance of national security export controls within the Departments of Commerce and State. The Departments of Commerce and Justice, as well as the Treasury Department's Customs Service, toughened their enforcement of export regulations.

Abroad, the United States spearheaded the updating of the COCOM control list to include major new dual-use technologies. It has urged other COCOM governments to enforce export controls more vigorously. At the COCOM Senior Political Meeting held in France in January 1988, COCOM member governments agreed to strengthen national export control systems and to share information more rapidly to prevent illegal transfers. These governments now are working toward a "common standard level of effective protection of controlled goods and technologies in all COCOM countries," with a view to the "eventual elimination of licensing requirements" within COCOM.[6]

The Western allies also are dealing with the international spread of technology beyond North America, Western Europe and Japan. COCOM nations are pursuing the Third Country Initiative, under which they agree to share Western technology with newly industrializing nations in return for guarantees to protect that technology from Soviet bloc officials and agents. Already, ten neutral European and Asian nations have improved their export control programs or established such programs where none existed.

V. IMPACT ON STRATEGIC RELATIONSHIP

This reenergized system of technology security has complemented the surge in technology development spurred by the U.S. economic recovery and by greater investment in defense R&D. During the 1980's, these factors combined to increase U.S. lead times in many technologies critical to defense. In April 1989, the CIA testified to the Joint Economic Committee that the United States held leads over the Soviet Union of from 7 to 15 years in advanced microcircuits, mainframe computers, supercomputers and flexible manufacturing systems. CIA also estimated that the U.S. led by 3 to 10 years in minicomputers, computer-operated machine tools and fiber-optic equipment.[7] One reason why the U.S. technological lead in manufacturing microchips grew in the 1980's is that the United States and COCOM ended the transfer of microchip manufacturing technologies, which greatly enhanced Soviet and Eastern European capabilities in the 1970's.

The reassertion of U.S. and allied advantages in strategic technology has strengthened Western nuclear and conventional forces and helped reverse the Western strategic decline of the 1970's. By the mid-1980's, the combination of Western political resolve and military strength also had helped bring striking progress in arms control. When NATO deployed American intermediate range nuclear force (INF) missiles despite heavy Soviet pressure, the Soviets returned to negotiations that they had earlier walked out of. Within two years they accepted the U.S. position that the entire category of land-based intermediate range missiles should be eliminated. The INF Treaty was signed at the Washington summit in December 1987.

At the Strategic Arms Reduction Talks (START), the United States rejected Soviet demands that the U.S. renounce testing or deployment of the Strategic Defense Initiative (SDI) before talks on reducing strategic offensive forces could begin. In September 1987, the Soviets gave some ground on their opposition to SDI, and both governments accepted the goal of a 50 percent reduction in offensive forces. The USSR has made concessions to the long-standing United States insistence on deep cuts in large land-based Soviet missiles with several warheads, which threaten a preemptive strike against land-based U.S. missiles.

Finally, the improvement of NATO's nuclear and conventional forces (together with the economic requirements of perestroika) has made the Soviet Union more receptive to NATO's proposals that the Warsaw Pact reduce substantially its very large, blitzkrieg-oriented conventional forces. In December 1988, General Secretary Gorbachev stated at the United Nations that by January 1991 the Soviet Union would withdraw 10,000 tanks, 8,500 artillery systems, and 800 combat aircraft from Eastern Europe and the European part of the USSR. In March 1989, NATO and the Warsaw Pact began the Negotiation on Conventional Armed Forces in Europe (CFE).

V. FROM THE 1980'S TO THE 1990'S

We now hear statements that improvements in East-West relations are making technology security superfluous, even harmful. Gorbachev seeks Western technology to help restructure the Soviet economy. This has intensified Soviet attacks on Western export controls. For example, in February 1988 a Soviet representative to the 35-nation Conference on Security and Cooperation in Europe (CSCE) charged that "COCOM prohibitions" and other "unjustified discriminatory barriers" were blocking "economic and scientific and technological cooperation" in Europe and had led to the "technological division" of Europe.[8] This Soviet approach has found some resonance in Western business circles, and with a few political leaders.

The United States and other Western governments, however, have strong reason to maintain controls on strategic trade even as non-strategic trade between West and East increases. Much of the transfer of technology that the Soviet government favors in the name of perestroika could bolster the Soviet military position vis-a-vis the West. This, in turn, could undercut Western plans to use new technologies to strengthen NATO's defenses while negotiating reductions in Soviet capabilities for surprise attack. Thus, effective technology security can help ensure that the present easing of East-West tensions goes beyond the short-lived and disappointing detente of the 1970's and promotes (in NATO's words) a 'just and lasting peaceful order in Europe." [9]

VI. HOW THE SOVIET MILITARY SEES HIGH TECHNOLOGY

Soviet military leaders believe that key advanced and emerging technologies are bringing a revolution in military affairs that could decide a future war. In this view, the dual-use technologies of the 1970's and 1980's will have a cumulative military impact comparable to that brought by tanks and aircraft in the 1920's and 1930's and by nuclear warheads and long-range ballistic missiles in the 1950's and 1960's.[10] The Soviets probably oppose the SDI as much because of a broad concern that it will have a powerful, synergistic effect on U.S. defense-related technology as because of a specific concern that it will counter present and projected Soviet offensive missiles.

The outstanding proponent of technological modernization, Marshal Nikolai Ogarkov (Chief of the General Staff, 1977–1984), continually has emphasized the military implications of what Soviet writers call the "scientific and technical revolution" of the late twentieth century. Ogarkov and other high-ranking officers have stated that technologies are changing so rapidly that the military competition between the Soviet Union and the West is increasingly becoming qualitative rather than quantitative. This view is similar to the argument of Soviet economic reformers that eco-

nomic progress should no longer be judged by the number of items produced but by their quality and usefulness. Changes in the Soviet defense budget over the past decade reflect this judgment: investment in military R&D has risen more rapidly than spending for weapons procurement.[11]

Soviet military writers anticipate improvements in nuclear weapon systems, and foresee important military applications for laser, particle beam, electromagnetic pulse and low-observable (stealth) technologies. They also describe potentially dramatic, near-term gains in certain conventional weapons, particularly in capabilities for devastating deep strikes against enemy forces. The Soviets speak of "reconnaissance-strike complexes" that combine long-range sensors, sophisticated communications, and highly accurate missile or other weapon-delivery systems. Such Soviet statements about deep strikes by conventional weapons recall the statement by former Under Secretary of Defense Perry that commercially-developed microelectronic and computer technologies have brought important military advances in "sensors, control and accuracy." (see Section I, above)

The Soviet military first developed its concept of deep strike, rapidly moving operations in the 1920's and 1930's, in connection with tanks and aircraft. In the early 1960's, the combination of nuclear warheads and long range ballistic missiles brought a new military doctrine, which stated that a future war would be decided by deep strikes by theater (European) or intercontinental range nuclear weapons. Now the military establishment seems to be adopting the view that many of the missions presently performed by theater nuclear weapons can be taken over by long range conventional weapons based on new technologies. In 1984, the leading military expert on the impact of firepower on tactics stated that the "new generation of armaments" will exceed their predecessors "'by several times over in range, by dozens of times over in destructiveness, and by hundreds of times over in accuracy." [12]

In principle, Soviet forces could use these technologies for either defensive or offensive operations. Soviet military writers state that the new weapon systems will strengthen the defender, by allowing him to locate and strike the attacker well before the two armies make contact. From this viewpoint, the new technologies eventually could give weight to Gorbachev's publicly proclaimed "defensive doctrine," according to which Soviet forces gradually will become armed and organized in such a way that they cannot threaten to attack any nation.

To date, however, the bulk of Soviet writings, deployment of forces9 and training exercises support an offense-oriented rather than a defense-oriented doctrine. They draw on the tradition of deep strike, rapidly moving operations that was applied to tanks and aircraft in the 1920's and ballistic missiles in the 1960's, and that found expression under Brezhnev in what the Defense Policy Panel of the House Armed Services Committee has described as an "offense-oriented, war-fighting strategy," emphasizing the "critical importance of seizing the initiative quickly—by preemption in the event of nuclear war and massive blitzkrieg tactics in a conventional conflict." [13]

The United States and NATO agree that the Brezhnev strategy remains basically in place. After hearings held in July 1988, the House Armed Services panel concluded that to date Gorbachev's statements about a defensive doctrine and "reasonable sufficiency" in defense spending had produced no "concrete, operational changes" in Soviet military behavior—procurement of weapons, deployment of forces, or training exercises.[14] A month later, Secretary of Defense Carlucci told the Military Academy of the Soviet General Staff that the United States had "difficulty in reconciling a defensive doctrine with what we see in Soviet force structure and operational strategy as an emphasis on the offensive—especially on surprise and maneuver." [15] NATO stated in December 1988 that the "major threat to stability in Europe" comes from those weapon systems that are capable of "mounting large-scale offensive operations" and of "seizing and holding territory." NATO noted that the Warsaw Pact has a "massive preponderance" in such weapons and that they are concentrated in a manner which raises "grave concerns about the strategy which they are intended to support." [16] Most recently, Secretary of State Baker said in May 1989 that "for all the talk of "defensive defense," Soviet military exercises still continue to show a marked inclination for taking the offensive." [17]

These judgments indicate that we do not yet know how sharply the strategy and force structure of the Gorbachev era will diverge from those of the Brezhnev era. Therefore, we do not know whether the Soviet military will use high technology to decrease or to increase the threat of a blitzkrieg offensive against the West.

VII. HOW PERESTROIKA CAN STRENGTHEN SOVIET MILITARY POWER

The Soviet military has the same sense of urgency about modernizing its system that Gorbachev has about modernizing the Soviet economy. Military leaders know that they suffered technologically from what now is stigmatized as the economic stagnation of the 1970's and early 1980's. They believe that the Soviet economy must undergo a major restructuring to create the broad scientific and technical base that they need to compete with the West in military technology.

Moreover, the military establishment has its eye on many of the same technologies as do civilian economic reformers. For example, in the late 1970's and early 1980's military journals noted that the USSR's failure to invest sufficiently in machine-building was hurting the defense sector. Subsequently, machine-building was made one of the highest priorities in the current, 12th Five Year Plan (1986–1990). The CIA has testified to Congress that "many of the products needed for Gorbachev's modernization program" in the areas of information processing, computers and microelectronics also have "military applications." [18] Some Soviet military statements acknowledge the overlapping of advanced civilian and military technologies in a manner that is almost a textbook definition of dual-use technology. In 1985, a Soviet general officer stressed that the Communist Party was committed to the "acceleration of scientific-technical progress" in connection with "strengthening military-economic potential." He expanded by stating that: the most important elements in scientific-technical progress—further, high priority development of machine building (particularly machine tool-building), robot technology, computer technology, instrument-making, and electronics—are also the catalysts of military-technical progress.

A year later this officer reiterated that "investment in the core high-technology branches of machine-building and other sectors which determine scientific and technical progress" enables the Soviet Union "to react promptly to the attempts of imperialist circles to upset the military-strategic parity in their favor." [19]

The Soviet government is trying to acquire those dual-use technologies that Soviet military leaders deem critical to the next stage in the East-West military competition. According to the Defense Technology Security Administration (DTSA), sensors, computers, microelectronics and telecommunications were among the technologies most sought by the USSR in the mid-1980's. DTSA also has noted Soviet efforts to acquire automated production and control systems, such as computer aided design manufacturing.[20] These systems are critical to the modernization of the Soviet machine tool industry, for military as well as civilian uses.

In the political climate of glasnost, the Soviet Union has new, legal opportunities to obtain Western technology. Soviet industrial ministries and enterprises are trying to establish joint ventures with Western firms that produce sensitive technologies. Soviet bloc governments are using the CSCE and its follow-up meetings to press for Europe-wide conferences on topics of potential military value like transportation networks and biotechnology. The USSR also has proposed topics with direct military applications for bilateral American-Soviet agreements, like those on Space Cooperation and Basic Sciences.[21]

Meanwhile, Soviet illegal activities continue unabated. In October 1988, the State Department's Senior Representative for Strategic Technology Policy noted that the United States faced a Soviet Union where "the defense budget continues to increase," "formidable military deployments remain in an offensive posture," and "illicit Soviet efforts to obtain foreign strategic technology are undiminished." [22] In May 1989, Secretary of Commerce Mosbacher told the U.S.-USSR Trade and Economic Council that he found it "frankly difficult" to commit himself fully to a "new era of trade with the Soviet Union" while "Soviet efforts to acquire proscribed Western technology continue." Secretary Mosbacher stated that "efforts to acquire such Western technology illegally should stop." [23]

We cannot yet judge how, over time, the Soviet government will allocate advanced technologies between civilian and military uses. Gorbachev has promised to reduce the military budget over the next few years, and he is insisting that the defense-industrial ministries produce consumer goods. Moreover, Gorbachev's personal control over the military and other potentially "anti-reform" institutions makes it unlikely that the military aspires to the type of almost unchallenged, privileged position that it enjoyed during its "golden age," from the mid-1960's through most of the 1970's. These political developments may foreshadow a fundamental shift in the Soviet economic system that will weaken the defense industry and the military leadership in the way the West hoped would occur in the 1970's.

Other trends, however, suggest that Gorbachev's reforms may strengthen the Soviet military. Defense spending continues at, or slightly above, the Brezhnev

level—15 to 17 percent of Soviet Gross National Product in 1988 (compared to 5.9 percent in the United States).[24] Although Gorbachev has announced a 19 percent reduction in production of armaments, there are no indications yet that Soviet production of major military weapons has decreased from the past high levels of production.

Moreover, Gorbachev's insistence on retooling factories and on absorption of new technology may invigorate many of the industrial enterprises and research centers that military reformers count on to help modernize the armed forces. Abraham Becker has argued that the distinction between military and civilian industry is likely to become "fuzzier," with the "barriers" between the sectors turning into "more permeable membranes." For this reason, Becker posits, the "Gorbachev program" might bring the Soviet Union to the "threshold of exploiting the possibilities envisioned by Ogarkov." [25] Thus, perestroika may be establishing a new set of "commanding heights" in the Soviet economy, occupied by dual-capable ministries and enterprises that can shift emphasis between civilian and military technology at the direction of the Soviet leadership.

On balance, it seems unlikely that Gorbachev's economic reforms will weaken permanently the military's claims on Soviet high technology. In September 1987, the CIA told Congress that "most signs" pointed to "broad-based military support" for economic modernization because this would strengthen the USSR's "long-term military competitiveness" with the United States.[26] Although judgments about military support for Gorbachev might be more cautious in 1989, it still seems reasonable to assume that the transfer of Western dual-use technology to perestroika will not undercut the Soviet military system and may instead make that system more effective.

VIII. TECHNOLOGY SECURITY IN WESTERN MILITARY STRATEGY

Because the United States remains uncertain about the direction of Soviet military policy, the U.S. must maintain its present edge in defense-related technology.

That edge remains critical to the defense of Western Europe. If the Soviet Union and other Warsaw Pact nations carry out the unilateral reductions they had announced as of March 1989, they still will outnumber NATO by over 2-to-1 in tanks, artillery and armored infantry fighting vehicles and by almost 2-to-1 in combat aircraft.

Furthermore, the Soviet Union has been modernizing its equipment steadily over the past two decades. It now equals the United States in level of technology in its tanks, infantry fighting vehicles and artillery; it is reducing the U.S. technological lead in combat aircraft. Therefore, even if the Warsaw Pact agreed to and implemented large, asymmetric reductions that lowered its numerical totals approximately to NATO's level, the West still would face a potential adversary that was technologically competitive in deployed weapons.

NATO must continue to rely heavily on nuclear arms to deter any attack by this adversary. The Alliance plans to modernize its post-INF theater nuclear forces, and the United States now is -12-

modernizing its strategic nuclear forces. But much of NATO's current focus is on conventional weapons incorporating dual-use technologies. In 1984 NATO adopted the doctrine of Follow-On Forces Attack (FOFA), which uses long range, ground- and air-based conventional weapons to attack enemy reinforcements and supporting units moving toward the forward battle area. In 1988, Secretary of Defense Carlucci stated to the Congress that FOFA relies on "integrating advanced and emerging technologies into established conventional forces." Secretary Carlucci further noted that FOFA has been made possible by rapid advances in sensors, microprocessors, communications and munitions.[27] These are the technologies that Soviet military leaders consider critical to the coming revolution in military affairs and that the Soviet government is trying hard to acquire.

More broadly, the Department of Defense is developing the Competitive Strategies Initiative, designed to align enduring Western strengths against persistent Soviet weaknesses. The first two Competitive Strategies task forces have examined how the United States should change its doctrine and deployments to capitalize on advances in automatic data processing, electronic miniaturization, communications, conventional munitions and long range, highly accurate weapons. In April 1989, Secretary of State Baker referred to developments like these by stating that "new" military technologies" will be able to provide "greater stability" at "lower levels of forces." [28]

There are, then, two reasons why the West must protect its lead in advanced dual-use technologies. First, the United States and its allies must prevent the transfer of such technologies to the USSR, where they could increase Soviet capabilities

for surprise attack and large-scale offensive operations. In the words of the State Department's senior official for strategic technology, "relaxing our efforts in COCOM in the face of the continued Soviet strengthening of offensive, conventional arms" would be "profoundly inimical to the security of the West." [29] Second, NATO needs these technologies to bolster its own defenses by acquiring the systems necessary for executing FOFA and by continuing to develop new areas of comparative advantage through the Competitive Strategies Initiative. The USSR could more easily neutralize these efforts to improve Western defenses if it acquired the technologies on which these improvements are based.

IX. HOW TECHNOLOGY SECURITY SUPPORTS ARMS CONTROL NEGOTIATIONS

Technology security also is critical to the continued success of U.S. conventional and strategic arms negotiations.

The NATO governments stated in December 1988 that Gorbachev's promises to reduce Soviet forces and to adjust Soviet force posture were "hopeful developments" but that negotiations were necessary "to correct the large asymmetries that will still remain" and "to secure a balance at lower levels of forces." NATO specified that according to its "concept of stability," no country should be entitled to possess more than a fixed proportion, such as 30 percent, of the total holdings in Europe in each category of equipment. NATO also noted that the Soviet Union possesses more tanks and artillery than all the other members of the Warsaw Pact and NATO combined.[30]

Why should the Soviet Union consider such sharp reductions? Undoubtedly Gorbachev wishes to reduce defense spending in order to assign more resources to broad economic and technological modernization. As we have noted, however, the Soviet military still receives the same share of Soviet GNP as under Brezhnev, and military strategy, deployments and exercises seem to be yielding only slowly to the demands of Gorbachev's doctrine. This suggests that the Soviet military establishment will play a powerful role in the CFE negotiations.

The experience of INF and START indicates that the Soviet military is more likely to accept arms reductions when the alternative is the improvement of Western forces. With regard to conventional forces, we know that Soviet military leaders believe both that rapid changes in technology can affect military capabilities dramatically and that the Western nations are superior to the USSR in developing new technologies and in using them synergistically. Therefore, it seems reasonable to assume that the Soviets may be willing to reduce their conventional forces significantly to prevent NATO from using its advanced technologies to revitalize its military posture.

Moreover, progress on NATO's Follow-On Forces Attack and on other Competitive Strategies is the best way to draw Soviet military strategy and deployments in a truly defensive direction. It is encouraging that in the mandate for the CFE negotiations, the USSR accepted the long-standing Western objective of "elimination, as a matter of priority, of the capability for launching surprise attack and for initiating large-scale offensive action." [31] In May 1989, the Warsaw Pact accepted several of NATO's proposed numerical limits on ground combat weapon systems.

If Soviet military leaders see that NATO is using the "revolution" in dual-use technologies to weaken the prospects for a successful Warsaw Pact offensive, they may judge that this revolution has in fact brought an historic change in the relationship between the offense and the defense. In that event, the present Soviet offense-oriented strategy and deployments may begin to appear militarily outmoded (as well as economically burdensome). The Soviet military would be unlikely to reach this conclusion if NATO did not keep a decisive lead in the technologies at the cutting edge of military power.

Technology security also can help ensure that a START Treaty enhances strategic stability. The United States and the Soviet Union are pointing toward a reduction of 50 percent in each side's strategic offensive forces. Such reductions should be stabilizing because they will include major cutbacks in large land-based Soviet missiles, which pose the greatest threat of a preemptive strike against U.S. land-based weapons.

But the United States must be on its guard if it tries to retain an effective nuclear deterrent with a smaller number of weapons. For example, if the United States reduces the number of ballistic missile-launching submarines, the U.S. will have to be even more careful in protecting technology that could improve Soviet attack submarines, which have the mission of destroying ballistic missile submarines. Also, it will be important to protect low-observable (stealth) technology. Strategic bombers will depend heavily on this technology to maintain their capability to penetrate the continuously upgraded Soviet air defenses.

X. CONCLUSION

In the 1980's, export controls on dual-use technologies have helped to restore American military power and to strengthen military stability in both nuclear and conventional forces. That restoration has allowed the United States to negotiate effectively with the Soviet Union for reductions in intermediate and intercontinental range nuclear weapons.

Because we cannot yet foresee the direction of Soviet military doctrine, deployments and use of high technology, the United States must keep technology security at the center of its national security policy for the 1990's. The Western alliance must maintain its technology edge if it is to modernize its own weapons and persuade the Soviet Union to move away from a military posture that could support a preemptive nuclear strike or a blitzkrieg conventional offensive. To ensure this lead, the West must combine vigorous promotion of dual-use technology with vigilant protection of that technology. This means that the United States must continue to treat strategic technology as one category of U.S.-USSR commercial relations that is governed primarily by military rather than by economic considerations.

Notes

[1] An Analysis of Export Control of U.S. Technology—A DoD Perspective. A Report of the Defense Science Board Task Force on Export of U.S. Technology, February 4, 1976 (Washington: Office of the Director of Defense Research and Engineering, 1976), p. 25. The report was named after task force chairman J. Fred Bucy, Executive Vice-President of Texas Instruments.

[2] William J. Perry, "Strategic Weapons Exploit Electronics," IEEE Spectrum, Volume 19, Number 10 (October 1982), p. 94.

[3] The Export Administration Amendments Act of 1985, Public Law 99-64, Section 3(2)(A).

[4] For the origin and strategic justification of COCOM, see Sumner Benson, "United States Policy on Strategic Trade with the Soviet Bloc," in Angela E. Stent, editor, Economic Relations with the Soviet Union: American and West German Perspectives (Boulder, Colorado and London: Westview Press, 1985), pp. 100-109.

[5] U.S. Government, Soviet Acquisition of Militarily Significant Western Technology. An Update (Washington, September 1985), pp. 6, 31-34.

[6] U.S. Department of State, Results of the Senior Political Meeting on Strengthening the Coordinating Committee on Multilateral Export Controls (COCOM). Press Release, January 29, 1988 (Washington: Department of State). Ambassador Allan Wendt, U.S. Export Control Policy: Its Present and Future Course, Address to the Atlantic Council of the United States, June 14, 1988. Current Policy No. 1094 (Washington: Department of State, Bureau of Public Affairs, August 1988), p. 2.

[7] The Soviet Economy in 1988: Gorbachev Changes Course, A Report by the Central Intelligence Agency and the Defense Intelligence Agency Presented to the Subcommittee on National Security Economics of the Joint Economic Committee, Congress of the United States, April 14, 1989, figure 3. For a 1987 comparison, see John P. Hardt and Richard F. Kaufinan, "Gorbachev's Economic Plans: Prospects and Risks," in Gorbachev's Economic Plans. Study Papers Submitted to the Joint Economic Committee, Congress of the United States, 2 volumes, November 23, 1987 (Washington: Government Printing Office, 1987), Volume 1, p.

[8] On the State of Affairs in the "Second Basket," Statement by the Head of the USSR Delegation Yu. Hashlev at the Plenary Meeting, February 12, 1988 (typescript, unofficial translation), p. 4. The "second basket" of CSCE deals with economics, science, technology, and the environment.

[9] North Atlantic Council Ministerial Communique, December 1988, paragraph 1. Text is printed in NATO Review (Brussels), Volume 36, Number 6 (December 1988), pp. 22-24.

[10] See the analyses by William E. Odom, "Soviet Force Posture: Dilemmas and Directions," Problems of Communism, Volume 34, Number 4 (July/August 1985), pp. 1-14, and by John G. Hines, Phillip A. Petersen, and Notra Trulock III, "Soviet Military Theory from 1945-2000: Implications for NATO," The Washington Quarterly, Volume 9, Number 4 (Fall 1986), pp. 117-137.

[11] Under Secretary of Defense (Research and Engineering), The Fiscal Year 1987 Department of Defense Program for Research and Development, Statement to the 99th Congress, Second Session. 1986 (Washington: Department of Defense, February 1986), p. II-3.

[12] Quoted in Notra Trulock III, Kerry L. Hines, and Anne D. Herr, Soviet Military Thought in Transition: Implications for the Long-Term Military Competition,

PSR Report No. 1831, prepared for the Office of the Secretary of Defense/Net Assessment (Arlington, Virginia: Pacific-Sierra Research Corporation, May 1988), p. 36.

[13] The Defense Policy Panel of the Committee on Armed Services, U.S. House of Representatives, General Secretary Mikhail Gorbachev and the Soviet Military: Assessing His Impact and the Potential for Future Change (Washington, September 13, 1988), p. 2. This Soviet strategy is analyzed and placed in historical context in Peter H. Vigor, Soviet "Blitzkrieg" Theory (New York: St. Martin's Press, 1983).

[14] Defense Policy Panel, pp. 2, 5, 9–12, 15. For interpretations of recent trends in Soviet military doctrine, see the articles by Raymond Garthoff, Andrew Goldberg and Jean Quatras in The Washington Quarterly, Volume 11, Number 3 (Summer 1988), pp. 131–183.

[15] Prospects for the U.S.-Soviet Dialogue, Remarks prepared for delivery by Secretary of Defense Frank C. Carlucci to Voroshilov Military Academy of the General Staff of the Armed Forces of the USSR, Moscow, August 1, 1988; printed as Defense Issues, Volume 3, Number 43 (Washington: Department of Defense, 1988), p. 2.

[16] Conventional Arms Control. Statement Issued by the North Atlantic Council Meeting in Ministerial Session at NATO Headquarters, Brussels, December 8–9, 1988, paragraph 4. Text is printed in NATO Review, Volume 36, Number 6, pp. 25–26.

[17] Secretary of State Baker, The Challenge of Change in U.S.-Soviet Relations, Address to the Center for Strategic and International Studies, Washington, May 4,1989. Current Policy No. 1170 (Washington: Department of State, Bureau of Public Affairs, May 1989), p. 2.

[18] Gorbachev's Modernization Program: A Status Report. A paper presented by the Central Intelligence Agency and the Defense Intelligence Agency for Submission to the Subcommittee on National Security Economics of the Joint Economic Committee, Congress of the United States, 19 March 1987, p. 35.

[19] Quoted in Abraham S. Becker, "Gorbachev's Defense-Economic Dilemma," in Gorbachev's Economic Plans, Volume 1, p. 382. I have made stylistic changes in Becker's translation and have added the emphases.

[20] Caspar W. Weinberger, Secretary of Defense, The Technology Security Program. A Report to the 99th Congress, Second Session (Washington: Department of Defense, 1986), pp. 12–17.

[21] For the increasing role of the leading Soviet scientific institution in military research over the past two decades, see John R. Thomas, "Militarization of the Soviet Academy of Sciences," Survey (London), Volume 29, Number 1 (Spring 1985), pp. 29–58.

[22] Ambassador Allan Wendt, U.S. Stance Toward the Soviet Union on Trade and Technology, Address to the Houston Club, October 27, 1988. Current Policy No. 1128 (Washington: Department of State, Bureau of Public Affairs, November 1988), p. 3.

[23] Remarks of The Honorable Robert A. Mosbacher, Secretary of Commerce, Delivered to The Twelfth Annual Meeting of the U.S.-USSR Trade and Economic Council, McLean, Virginia, May 16, 1989 (typescript, U.S. Department of Commerce), p. 7. For Soviet criticism of the speech, which also questioned the level of Soviet military spending and Soviet readiness to enter international economic organizations, see Karen Riley, "Secretary accused of cooling off trade," The Washington Times, May 18, 1989, pp. C1, C9.

[24] The Soviet Economy in 1988: Gorbachev Changes Course, p. 18.

[25] Becker, "Gorbachev's Defense-Economic Dilemma," pp. 383, 385. For an interpretation of Gorbachev's reforms as a high technology revolution from above modeled on the defense industry, see Paul Cocks, "Soviet Science and Technology Strategy: Borrowing from the Defense Sector," in Gorbachev's Economic Plans, Volume 2, pp. 145–160.

[26] Gorbachev's Program: Motives and Prospects, Statement by the Central Intelligence Agency to the Subcommittee on National Security Economics, Joint Economic Committee, Congress of the United States, September 14, 1987, p. 10. See also the judgment by Becker (p. 372) that the Soviet military may be prepared to trade off "short term restraints on military production and procurement" for the "future potential inherent in a technologically sophisticated R&D and production base."

[27] Secretary of Defense Frank C. Carlucci, Support of NATO Strategy in the 1990's. A Report to the United States Congress in Compliance with Public Law 100-180 (Washington: Department of Defense, January 25, 1988), p. V-1.

[28] Secretary of State Baker, Power for Good: American Foreign Policy in the New Era, Address to the American Society of Newspaper Editors, April 14, 1989. Current Policy No. 1162 (Washington: Department of State, Bureau of Public Affairs, April 1989), p. 1.

[29] Ambassador Allan Wendt, U.S. Export Control Policy: Its Present and Future Course, p. 3.

[30] Conventional Arms Control, paragraphs 4, 5.

[31] Mandate for Negotiation on Conventional Armed Forces in Europe, section titled Objectives and Methods. Text is printed in CFE. Negotiation on Conventional Forces in Europe (Washington: U.S. Information Agency, U.S. Department of State, March 1989), pp. 4–10. This booklet also gives NATO and Warsaw Pact totals in key categories of conventional weapons and Warsaw Pact totals after the implementation of announced unilateral cuts. The CFE Negotiation covers territory from the Atlantic to the Urals.

APPENDIX II

PREPARED STATEMENT OF RICHARD JOHNSON

WESTERN LENDING TO THE SOVIET UNION

There's an impression afoot that Western lending to the Soviet Union has surged in recent years, that the West is providing a big crick of extra resources for Gorbachev, and that if we could restrict "untied" lending we could control how the Soviet Union uses Western currency. This impression makes for dramatic headlines and stirring editorials for and against the notion of "helping Gorbachev reform." But it's just plain wrong.

The real story is very different and much less dramatic. Western lending to the Soviet Union remains modest, and from 1984 through 1987 the Soviets actually paid back about $3.7 billion more than they borrowed. During those years when the net flow of lending to the Soviet Union has been positive, borrowed Western money has added very little to the overall resources available to the very large, and still very closed, Soviet economy. And finally, restricting "untied" loans would not give the West control over Soviet hard currency spending.

Why are mistaken impressions about Western lending so widespread? For one thing, total Soviet debt has almost doubled in dollar terms since 1984, and it seems reasonable to assume this is due to a surge of Western lending. For another, Gorbachev appears intent on modernizing Soviet industry and improving Soviet consumer welfare, and it seems reasonable to assume this has meant greater Soviet reliance on Western equipment and consumer goods. Finally, it also seems reasonable, at first glance, to assume that "tying" Western loans to specific Soviet uses would give us some control. But what seems reasonable at first glance isn't always true.

If you want to know the real story on Western lending to the Soviet Union, you have to consider the following key points on the stock of Soviet debt and the impact of exchange rates, the flow of Soviet borrowing, its potential impact on Soviet spending, recent levels of Soviet imports from the West, and the notions of "tied" and "untied" lending.

Debt Stocks and Exchange Rates

The first key point is to distinguish between the flow of Soviet borrowing and the stock of Soviet debt, and to recognize the impact of exchange rate changes on the stock of debt.

The dollar value of the Soviet Union's hard currency debt stock is a measure of how much the Soviet Union owes the West at the end of each year. The debt stock reflects trends in borrowing flows. But it also reflects trends in the U.S. dollar value of the various currencies in which the Soviet borrow.

Western analysts measure the stock of Soviet debt in U.S. dollars because it's the best way to come up with a single figure. But the Soviets do a good deal (more than half since 1984) of their borrowing in non-dollar currencies. Loans in those non-dollar currencies have to be translated into dollar terms to produce a single figure for Soviet debt. So, when those other currencies go down in value against the dollar, the stock of Soviet debt expressed in dollars goes down. When those currencies go up in value against the dollar, the stock of Soviet debt expressed in dollars goes up.

That is what happened over the past few years; non-dollar currencies rose sharply against the dollar, and this made the Soviet debt stock go up sharply, as expressed in dollars. To illustrate; between 1984 and the end of 1987 the stock of Soviet hard currency debt increased by $18.6 billion, from $22.2 billion to $40.8 billion. But the cumulative impact of appreciation of non-dollar currencies against the dollar accounted for an estimated $14.7 billion or 79 percent of that apparent increase.

This exchange rate phenomenon (commonly called the "valuation effect") can be powerful enough to make the Soviet debt stock go up in dollar terms even when the Soviet Union is paying back more money than it is borrowing. This is what hap-

pened in 1987, when the entire increase in the stock of Soviet debt from $36.0 billion to $40.8 billion was due to the impact of the appreciation of non-dollar currencies against the dollar. The actual flow of Soviet hard currency borrowing in 1987 was negative: Soviet hard currency repayments exceeded new borrowings.

Gross Stocks and Net Stocks of Debt

So far we've been talking about the gross stock of Soviet debt. Meanwhile, the Soviets keep a large amount of hard currency in Western banks, mainly money they have earned from exports but also borrowed funds they choose to redeposit in the West. These deposits are hard currency assets, available but held in reserve. The more such assets a country has compared to its gross stock of debt (its liabilities), the better its overall external position: the gross stock of debt (liabilities) minus external deposits (assets).

At the end of 1987, the gross stock of Soviet debt was about $41 billion, but Soviet hard currency deposits in Western banks stood at about $15 billion. So their net stock of debt was about $26 billion. Generally, a country like the Soviet Union that holds foreign exchange assets equivalent to more than a third of its foreign exchange liabilities is considered to be in relatively good shape in terms of liquidity.

One final word an debt stock figures; the impact of exchange rates makes the gross or net stocks of Soviet debt poor measures of Soviet borrowing trends from year to year.

Borrowing Flows and the Net Transfer Measure

If you want to know how much hard currency is becoming available to the Soviets from borrowing, you have to put debt stocks aside, and think in terms of borrowing flows.

Looking at new borrowing from year to year is the first step in measuring the extent to which the Soviets are looking a the West for financial resources. But even as the Soviets draw down new loans, they are also paying back principal and interest on old loans. So the degree to which new borrowing provides additional resources depends on the level of repayments which the Soviets are making on old debt.

Therefore, the most accurate measure of the incremental hard currency available to the Soviets thanks to borrowing from year to year is the net transfer measure; total Soviet borrowing (Soviet drawings and medium and long-term commercial and official credits plus net short term credits) minus Soviet debt service (repayments of principal and interest).

This net transfer measure shows that the incremental hard currency available to the Soviets from borrowing averaged about $300 million per year from 1984 through 1986. In 1987, when the Soviets made new borrowings of $4.1 billion but repaid $8.7 billion of principal and interest on old debt, the net transfer measure was negative by $4.6 billion. When you look at the four year period 1984 through 1987 as a whole, the net transfer measure was also negative, by $3.7 billion. In other words, the borrowing and repaying process produced a net flow of hard currency from the Soviet Union and toward the West.

Stocks, Flows, and the Cost of Borrowing

There is one more critical point to remember about stocks and flows. Stocks refer to principal only. Flows involve both principal and interest. Between 1984 and the end of 1987, the Soviets came out ahead on their stock of debt: in constant dollars they borrowed about $3.9 billion more than they paid back. But they came out behind overall (the cumulative net transfer measure was negative by $3.7 billion), because they also had to pay back interest.

Interest payments—the cost of borrowing money—explain why the Soviet debt stock can rise in constant dollars even when the net transfer measure is negative.

Interest payments also reflect a basic fact of life in international borrowing; over the long run, you'll always come out behind on the net transfer measure. If you want to come out ahead in economic terms, you had better spend the money you borrow on some constructive purpose that has a higher rate of return than the rate of interest you have to pay on loans. If you don't spend the money you borrow on some constructive purpose, the borrowing process will leave you with less spending power in the long run.

Putting Borrowing Flows into Perspective

For incremental bard currency from borrowing to loom large Soviet spending decisions, the net transfer measure would have to loom large compared to other measures of Soviet resources or spending. Meanwhile, Soviet GNP was about $2.6 trillion in 1987 (measured in 1982 dollars); Soviet domestic spending on investment was

about 33 percent of Soviet military spending was about 16 percent of GNP; and Soviet hard currency earnings from the export of goods and services averaged about $33 billion a year in 1984–86.

Whichever figure you choose, the 1984–86 net transfer measure at $300 million a year looks quite modest. It is certainly far too small to justify the perception that the West, as some have put it, is "financing perestroyka," or "easing the choice between guns and butter."

Just how far Western lending is from having a significant impact on Soviet spending decisions can be gauged by assuming, for a minute, that the Soviets increase their new borrowing enough to multiply the 1984–86 average annual net transfer measure by a factor of ten, to $3 billion.

If the Soviets were to spend an extra $3 billion to import consumer goods, this would raise total Soviet consumption by about 0.3 percent—an extra 30 cents for every $100 consumed. And the impact on consumer goods shortages would be quite small: leading Soviet economists estimate the current shortfall of supplies of consumer goods at over $100 billion.

If the Soviets were to spend an extra $3 billion to import capital goods, the impact would also be quite small: this would amount to less than 1 percent of total investment. Effective use of such imports could produce significant results in individual sectors; but the odds of effective use are low because the Soviet pricing system remains as distorted as ever.

Of course, such an increase in borrowing would have to be repaid, with interest. If increased borrowing were used to boost consumption, it would not generate exportable goods to meet repayment obligations, and some time in the future goods would have to be diverted from domestic use to repay the loans. The same would apply if increased imports of capital goods were not efficiently used to increase exports.

To return from the hypothetical to the real world, it is worth noting that thus far, Soviet imports of capital and consumer goods are down under Gorbachev: Soviet orders of western machinery and equipment averaged $5.9 billion a year in 1980–84 but only $5.75 a year in 1983–87; Soviet imports of consumer goods averaged $9.1 billion in 1980–84 but only $5.6 billion in 1985–87.

Tied Versus Untied Lending

Along with the mistaken perception that Soviet borrowing has surged, another idea is afoot about a distinction between "tied" and "untied" lending. "Untied" loans, such as general purpose syndicated loans which are not earmarked for a specific trade transaction, accounted for a majority of Soviet borrowings in 1984–86. "Tied" loans, such as those foreseen under the credit lines announced in several European countries in 1988, are earmarked for specific trade purposes. Soviet preference "tied" or "untied" loans appears to depend on which is cheapest at any given time, in terms of commercial interest rates.

Some argue that "untied" lending to the Soviet Union is dangerous and should be restricted or altogether ended. The nominal idea behind this argument is that whereas "tied" lending provides money the Soviets can use only to import western goods and services, "untied" lending provides money that the Soviets can use as they see fit, and may use for purposes which cut against western interests—for example, military spending, or support for client states.

This argument forgets that money is "fungible," or interchangeable between uses. Any kind of borrowing, "tied" or "untied," can free up other money for other uses. If a country has lots of "untied" earnings which it already uses mostly for imports, and a little bit of newly "tied" borrowings specifically earmarked for imports, it can simply start putting me of the "untied" earnings it's been using to pay for imports its pocket, use the "tied" borrowing to pay for those imports instead, and end up with the same amount of discretionary spending power as it had before the borrowings were "tied." And the Soviet Union has access to a far larger amount of "untied" western currency than it gets from borrowing, thanks to Soviet hard currency earnings from exports.

Of course, as noted above, if you borrow to increase your discretionary spending power but fail to use your borrowing constructively, you end up with less discretionary spending power in the long run.

The fact that "tying" Soviet borrowings to Soviet purchases western goods and services would not reduce discretionary Soviet spending power is not intuitively obvious. But the fact that the only way to effectively control the uses to which the Soviets put hard currency would be to "tie" all Soviet hard currency export earnings to Soviet purchases of western goods. Or better yet, keep hard currency out of the picture altogether, by restricting Soviet trade with the West to barter transactions. Either one of these approaches, however, would be totally impractical, and

would also amount to a more restrictive approach to East-West trade than the West has ever tried to apply, even at the height of the Stalin era.

The Allied Approach

Meanwhile, the United States and our Allies have a consensus, expressed at the June 1988 Toronto Economic Summit, that "East-West economic relations can be expanded and serve our common goals so long as the commercial basis is sound, they are conducted within the framework of the international trade and payments systems, and are consistent with the security interests of each of our countries."

This means a readiness to expand peaceful trade with a reform-oriented Soviet Union, if the Soviets want to buy non-strategic goods and can make their goods attractive enough to sell in the West; but it also means no subsidies on lending, and careful monitoring of how much the Soviets are actually borrowing every year. This is a positive, vigilant approach. It may not seem dramatic. But it has served us well, and it has a good solid grounding, in reality.

Prepared Statement of John R. Thomas

US-Soviet Science and Technology Exchanges in US-Soviet Commercial Relations

Introduction

To fully consider US-Soviet commercial relations, we need to examine science and technology (S and T) exchanges between the two countries. For, science and technology develop the basic principles and know-how, as well as contribute to the production of instrumentation and equipment, that are often involved in commercial relations between industrial nations. In the context of US-Soviet relations, S and T exchanges have been an important part of those relations. In the 1970's, thousands of scientists on both sides were involved in such exchanges.

This paper summarizes the experience of that era as a basis for assessing how the US should conduct S and T exchanges with the USSR, as part of its commercial relations, in order to maximize the benefits the U.S. obtains from such activities and to minimize undesired technology transfer losses.[1] In this connection, note is taken of how USSR's ability to engage in mutually beneficial technology exchanges with the West is heavily limited by systemic, cultural/historical, organizational and other related factors. It is further noted how these factors affected the US S and T interaction in the 1970's and how they must be taken into account in future S and T exchanges with the USSR. Finally, the paper notes how the USSR, under General Secretary Gorbachev, is attempting to reorganize Soviet S and T to unleash its potential to help remedy USSR's economic problems and compete with the US.

Soviet Need for S and T Exchanges with the US

Soviet Union's current need for Western science and technology has arisen from the following background. Its massive investment in science and technology since the 1920's has not been matched by a comparable qualitative payoff except in a few select areas, such as theoretical physics, mathematics, power generation and metallurgy, even though the Soviet S and T community and the economy on the whole met quantitatively the high priority heavy industry and military requirements of the Soviet leadership. And even when the Soviets have momentarily forged ahead of the US, as for example in nuclear fusion research (Tokamak), they soon fell behind and thereafter were unable to keep up with the US (or the West), particularly in applying such research. Comparable examples might be cited in outer space activities: the USSR launched the first earth satellite (sputnik) in 1957 and manned orbital flight in 1961; yet it was the US that landed men on the moon in 1969, a feat the Soviets tried to emulate, and then abandoned. In fact, many Western observers believe that overall the scientific-technological gap between the US (and the industrially advanced Free World in general, including Japan) and the USSR is growing, particularly in information processing and communication. The central point underlined here is that the Soviets may score theoretical and experimental breakthroughs ahead of the West, but they often fail to translate these into effective application and production before the West does.

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[1] US-Soviet technology transfer is here defined broadly to include not only the transfer of products (equipment, instrumentation, etc.) but also of knowledge that can be applied in research, development and production. Under this definition, technology transfer covers both commercial/trade transactions, and scientific-technological exchanges and joint projects.

This deficiency of the USSR is not, and never has been, a question of the individual capabilities of its scientists and technologists. On meeting them, one is impressed by their individual knowledge and abilities. The latter is demonstrated by international recognition of their work; this has included Nobel Prizes won in Physics and Chemistry.

Then, too, a general lag in Soviet S and T achievements is not, and never has been, due to insufficient resources. Over the years, the Soviet regime has made massive investment in physical plant, education and training. For example, the Soviets currently have close to 2 million scientists, over 1/4 of whom have advanced Doctorate and Kandidat degrees. The USSR also has over 5,000 research institutes performing work across the widest S and T spectrum in the world. In fact, the Soviet regime's investment in science, has in some categories equalled or surpassed that of the US; thus, the Soviets have been investing over 3 percent of their Gross National Product in research and development (the heart of any S and T effort), compared to the normal US investment of under 3 percent. Moreover, the sizable Soviet investment has been made continuously, and not erratically as in the US case (in response, for example, to such events as the Soviet space sputnik breakthrough in 1957 or the first manned orbital flight in 1961.) Therefore, the qualitatively poor Soviet S and T performance and the resultant need for foreign technology, is due to other reasons, viz., the negative impact of systemic, organizational, historical and cultural factors; these are considered below. Here it should be underscored that the Soviet need for Western science and technology, arising from their own shortcomings, were magnified over the years by the ambitious set goals to speedily modernize USSR's economy and attain superpower status; they gained such status in the military area by a vast military build-up in support of a post-World War II activist foreign policy.

FACTORS AFFECTING SOVIET S AND T PERFORMANCE

Systemic

The basic factor affecting Soviet S and T performance to date is inherent in the Soviet system: the pervasive effort by the Party to control all elite groups in the Soviet system (the military, the governmental bureaucracy, the industrial production managers, the arts and literature community, and, finally but not least, the S and T community.) The Party's perseverance and overall inflexibility in exercising such control has been heavily reinforced by a selection process—through nomenklatura—that attempts to assure continuity in office of an elite bent on preserving its rule, even at the expense of modernizing the economy and its S and T components, and of increasing overall efficiency. This situation exists because the Party itself was not modernized after Stalin's death. Khrushchev tried unsuccessfully to do so with his proposed Party reforms in the 1960's. Designed to affect only the middle and lower levels of the Party apparat, and not the very top, e.g., the Politburo, his proposals aroused such widespread opposition that they were largely responsible for his downfall in 1964. This raises the most fundamental question of whether the Soviet system can, without being modernized and reformed at the highest policy command levels, provide the proper political setting for S and T achievements that match the material and human investment in S and T made by the Soviet regime. It remains to be seen whether Gorbachev truly desires and is able to carry out the needed fundamental political reforms such as abolition of the Party's monopoly.[2] Instead, will he effect a generational change without the necessary structural and attitudinal reforms that include eliminating the widespread bureaucratic intolerance of alternative views and approaches, and that enable dissidents to own printing presses, and have access to state-controlled radio and television stations, as is currently the case in Jaruzelski's Poland.

Organizational

Organizational factors also heavily affect USSR's ability to engage in mutually beneficial East-West S and T interactions. The Soviet S and T community suffers from organizational deficiencies that affect its ability to perform productively. Ironically, in a highly centralized political system, the Soviet S and T community is severely affected by a key fact of not having a "command center" for coordinating efficient R and D and production. On the contrary, duplication and counterproductive rivalries exist among and are fostered by the major S and T agencies: the USSR and the 14 Republic Academies of Sciences; the some 50 production ministries; and the State Committee for Science and Technology (GRNT).

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[2] In the Spring of 1989, he rejected internal reformist calls for a multi-party system.

In this context, the fragmented Soviet S and T community is plagued by three major problems. First, there are jurisdictional problems between the USSR Academy of Sciences and the GET that arose mom the Academy's loss of its monopoly over establishing and maintaining contacts with foreign science communities, and providing the main guidance for the development of Soviet science. (The Academy lost this monopoly after the forerunner of the GKNT was formed in 1961 because of Khrushchev's dissatisfaction with the Academy's performance.)

Secondly, there are problems between the Academy and some 50 Soviet production ministries over the issue of basic vs. applied science. Traditionally, the Academy has wanted to engage in basic research; the ministries, however, want the Academy's help on the applied end because of their need to meet production goals. In recent years, frictions have increased because the Academy no longer gets all its funds from the State Budget, as was the case earlier. Therefore, its research institutes must make up the funding shortfalls by obtaining contract work from production ministries; this allows the latter to exert pressure on the Academy to work on applied problems. In turn, this situation creates still another negative reaction: many Academy scientists on assignment (kommandirovka) to ministry enterprise are extremely unhappy because they have to be away from their prestigious Academy institutes to work on what many consider less challenging and interesting "nuts-and-bolts" production tasks.

Finally, there are problems between the State Committee for Science and Technology and the production ministries. The GKNT is charged with identifying foreign technology and having it introduced into a ministry's production process. But the ministries resist GKNT's effort to impose new technology on them because no allowance is made for the downtime involved in installing new equipment and retraining workers. Yet the interruption of production for such downtime can result in the manufacturing enterprises' inability to meet annual production goals which, in turn, affects bonuses and promotion. Consequently, the ministries resist innovation, even though over the long run it would lead to greater output.

Thus, it is ironic that, in a system which in the past proclaimed its rationality and planning, the establishment of GKNT and the subsequent reorganization of the USSR Academy of Sciences, including the transfer of some Academy research institutes to the jurisdiction of production ministries, have led to greater inefficiency and organizational problems instead of the intended streamlining and responsiveness to Soviet economic needs; in particular, this applies to the gap between research and application. To address these problems since Gorbachev's accession to power in 1985, new, integrated science-production complexes (MNTs) have been formed (as first announced in Izvestyia, the Soviet government's central organ, in mid-December, 1985.) To date, these have not produced any better results than similar measures enacted in the past, comparably labelled NPO's (scientific-production complexes). In recognition of such latest failure, the Gorbachev leadership is currently experimenting with new solutions: allowing the formation of non-governmental S and T cooperatives and, in turn, encouraging these to make direct arrangements with private science and industry abroad. But this latest effort is in danger of being smothered by new regulations and bureaucratic procedures.[3] In any case, the "new" measures have not solved the continuing and intruding problems between the Academy, GRNT and the ministries.[4]

Cultural/Historical Factors

Cultural and historical factors also play a role in the quality of Soviet S and T's performance. Russian science, represented at the leading edge by its Academy, which dates its founding back to 1724 under Peter the Great, was originally based on West European models; the latter were highly academic with little relevance to application and virtually none to production. A heavy residue of the academic approach remains in the USSR Academy of Sciences, the successor to the Russian Academy, despite the Soviet regime's efforts since the 1920's to bring the Academy's

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[3] For example, all foreign economic interactions, including those of Soviet scientists and technologists, are to be regulated by the Ministry of Foreign Economic Relations. This includes registration with the Ministry, and the latter's power to intrude into and suspend transactions when these are deemed to be "detrimental to the interests of the State." (See USSR Council of Ministers Decree No. 203 of 7 March 1989 on Measures for State Regulation of Foreign Economic Regulations.)

[4] Over the past several years, Soviet science leaders, e.g., Marchuk, the USSR Academy's President, and Sagdeev, the space program leader, have offered scathing critiques of the continuing Soviet S and T problems. (See Marchuk's speech at the CPSU's Party Conference in June, 1988 and Sagdeev's article in US National Academy of Sciences' Issues in Science and Technology, Summer, 1988.)

research institutes closer to application and production.[5] Then, too, even though statistically the Soviet population is now heavily urban, in reality it still retains psychologically a highly rural mentality, particularly in regard to time and labor discipline. This is most noticeable among Soviet workers outside the main centers of Moscow and Leningrad; though called on to run modern machinery or work in advanced laboratories, many workers still have the outlook of the derevnya (viz., relaxed rural attitude) toward industrial production and discipline. This cultural/technological lag affects the performance of both Soviet manufacturing enterprises and the S and T community.

Other Relevant Factors

Other factors, bearing adversely on Soviet S and T performance and creating a need for Western technology, can be cited. Thus, the Soviets do not have the necessary supporting infrastructure for efficient S and T development, e.g., they lack the many small supply companies that exist in the US to provide instrumentation, Bunsen burners and test tubes, chemicals and other common supplies needed to conduct experiments and tests. As a result, many Soviet scientific institutes must divert personnel and time to obtain or themselves make such equipment and supplies. This inefficient situation is due mainly to the traditional Soviet priority on military and heavy industry production, carried out at the expense of balanced economic development that should include appropriate supporting infrastructure to meet the needs of the civilian economy and the S and T community.

Here again it remains to be seen whether Gorbachev will succeed in establishing such a balance, by reallocating resources away from the military and heavy industry. To date, such reallocation has nor occurred. According to US intelligence estimates, Soviet military production continues to increase, though at a lower annual growth rate. (See Report on the Soviet Economy in 1988, presented by the CIA and DIA on April 14, 1989 to the Joint Economic Committee of US Congress.)

THE EFFECT OF DIFFERING US AND SOVIET S AND T APPROACHES

The Soviet S and T approach (in philosophy, organization and policy) differs significantly from that of the US. It thereby can affect (and has) the nature and mutuality of benefits intended in US-Soviet S and T exchanges, and the larger technology transfer interactions. The following differences are noted illustratively. Frequently, under Soviet S and T policy, problems are tackled in a narrow context. This often involves, for example, the establishment of separate institutes with massive funds and personnel focused narrowly on specialized S and T tasks, whereas US R and D addresses questions over a broader scientific range. Then, too, the Soviet S and T funding plans cover many years; this can be strength in providing continuity in efforts to score breakthroughs, but a weakness in continuing to expend funding on work that may be irrelevant to current needs.

Similarly, the Soviet educational system heavily controls where its S and T graduates will work on completion of their education. This is strength in planning to meet the Soviet economy's needs, as perceived by the Soviet leaders, but may be a weakness in misdirecting manpower resources, arising from political, instead of scientific-technical, judgments at top levels. These judgments may not be alert to, or comprehend the significance of, the latest S and T trends, and, therefore, may lock Soviet S and T manpower into work which is no longer on the leading edge of S and T developments. Such misdirection of manpower wastes skills and dampens enthusiasm and initiative.

The Soviet Communist Party's control structure, embedded in the Soviet S and T community (similar, for example, to the parallel Party structure in the Soviet military, viz., the Main Political Administration), can be strength in imposing the Party's will on the S and T community to meet the leadership's priorities. But the situation also constitutes a weakness when it results in political hacks substituting their ill-informed judgment for those who are more familiar with S and T trends and who could anticipate and meet Soviet requirements more productively.

Also, the Soviet S and T community is politicized (and thereby rendered less effective) not only because of the Party's pervasive controls, but also because it is subjected to an organizational straightjacket: it is totally a part of the State framework. (This contrasts with the U.S. S and T community, which is divided among government, academia, and private industry.) As a result, the "all-State" context frequent-

[5] A significant exception to this has been the Academy's heavy and increasing involvement in military research and development. For detailed discussion see John R. Thomas, "Militarization of the Soviet Academy of Sciences," Survey (don), Spring 1985.

ly does not allow for alternative or creative exploration of S and T problems. Yet, such exploration is likely to produce better results—as it has in the US—than a monopolistic, State-directed S and T effort, afflicted by indifferent, insensitive or illiterate judgments of the Government bureaucracy, comparable to those of the Party apparat.

Moreover, as part of the Party's and State's control over travel and contacts of Soviet citizens, the access of Soviet scientists and technologists to foreign S and T communities is highly controlled and limited. This prevents the greater and freer interaction between foreign and Soviet S and T communities that could serve as a stimulus to better S and T results (This contrasts with untrammeled access by US scientists and technologists to their counterparts abroad.)

Then, too, the Soviet S and T community itself, like the system as a whole, is highly centralized within each of the major components that make up that community, viz., the USSR Academy of Sciences, GRNT and production ministries. This creates the problem of "The Center" versus mestnikh ("the locals"), i.e., the strains between the scientific technological hierarchy and facilities in Moscow and the S and T communities elsewhere in the 15 Soviet Republics. The regional communities consider the "Muscovites" to be overbearing in their direction and oversight of local S and T work. In the 1970's this was reflected by Moscow-based central (or lead) research institutes taking over cooperative activities with US scientists, even though arrangements were worked out originally by local institutes outside the Soviet capital. (Again, this over centralized Soviet approach contrasts with the relatively decentralized process in the US.)

Finally, a related problem affecting the US-Soviet S and T cooperation, stems from the domination of the Soviet S and T community by the Russians vis-a-vis the many other nationalities that make up the USSR. Russian scientists have monopolized the joint activities with the US, comparable to their sway over the Soviet S and T community's hierarchy and activities. This situation, again, parallels the Great Russian domination of the political system, and contrasts with the US "melting pot" approach that reduces majority vs. minority tensions. The recent outbreak of nationalities' unrest in the USSR implicitly reflects the resentment of Russian dominance in all areas of Soviet activities.

US-SOVIET S AND T COOPERATION IN THE 1970'S

The factors noted above affect the ability of the Soviet S and T community to interact with its foreign counterparts on the basis of mutual benefit, particularly with the advanced communities such as the US. This is illustrated by our widest experience to date: the S and T exchanges and joint activities conducted most actively in the 1970's under the 11 bilateral US-Soviet government agreements.

These agreements were concluded in 1972-74 for an initial period of five years. They included "the umbrella" Agreement on US-Soviet Cooperation in Science and Technology and the 10 other specialized agreements in areas such as space, ocean research, energy, public health and medicine, agriculture, and transportation. Many were renewed on expiration of the initial period.[6]

In promoting cooperative projects and joint activities with Soviet scientists and technologists at the height of "detente" in the mid-1970's, the US was guided by a major consideration: to support exchanges in areas in which the USSR had done advanced work or had invested resources and manpower in solving S and T problems that could save US scientists time and duplication of effort. For example, this applied in theoretical physics, in some areas of energy (e.g. magnetohydrodynamics), in material sciences (particularly metallurgy), and in metal work (e.g. welding). The US also sought to benefit from access to unique Soviet data or records, e.g., large-scale records on heart and other diseases gathered by State-directed Soviet medicine, and not maintained as widely and systematically in the West.

In connection with these goals, the US selected and subsequently supported joint activities which had some or all of the following actual or potential features designed to maximize successful interaction between US and Soviet scientists and technologists:

1. Cooperative projects in both basic and applied sciences;
2. Indication on both sides of substantial interest in cooperation;

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[6] However, most activities under these agreements were halted or reduced by the US in reprisal for Soviet invasion of Afghanistan in 1979, the imposition of Martial Law in Poland in 1981, and Soviet shootdown of the Korean 007 airliner in 1983. But the pace picked up again, after President Reagan expressed his support for expanding exchanges and contacts with the Soviet people at a meeting with US administrators and coordinators of science exchanges on June 27, 1984 and at subsequent Summit Meetings.

3. Evidence of significant Soviet scientific capability or achievement in order to maximize benefits to the US from a joint activity;

4. Prior familiarity of US scientists with their Soviet counterparts and their work;

5. Evidence of Soviet willingness to contribute to mutually beneficial interaction, e.g., allowing their first-rate scientists to travel to US for joint scientific meetings; and,

6. Appropriate arrangements lending themselves to long-term cooperation, e.g., continuing joint projects and seminars.

The US used the following criteria to assess the success of the joint activities it supported:

1. Did the interaction provide access to first-rate Soviet scientific technological personnel and facilities?

2. Did the interaction contribute to our knowledge of the work of Soviet scientists and technologists?

3. Did the interaction produce concrete results, such as publications, which permitted dissemination of newly gained information or knowledge to the US scientific and industrial community at large?

From the US viewpoint, the results of the US-Soviet S and T interaction in overall terms were decidedly mixed: mutual benefit in a few areas and less than hoped-for results in other. While the US gained much intangible results (e.g., information about Soviet S and T policy and organization, and expanded personal contacts with Soviet scientists), the scope and the quality of the joint activities and resultant S and T benefits to US were affected by many detrimental Soviet policies and practices noted below.

Problems that Affected US-Soviet S and T Cooperation in the 1970's

In general, S and T exchanges with foreign communities pose a special problem for the USSR. Unlike transfer of equipment, machinery or blueprints, such exchanges involve human interaction. This means the involved personnel can look, talk, listen and, most important, be influenced by such human interactions. For a regime that has tried to shield its people from or limit their contacts with the outside world (except for those cleared for such contacts), exchanges entail exposing its S and T community, a key group, to foreign influence in a most intimate context—one-on-one. This is even more sensitive than visits by performing theater and music groups which are on stage for only a few hours, with little chance for personal, individual and continuing contact enjoyed daily by foreign scientists in the labs of the host country. Such contact provides great concern to a Soviet regime bent on minimizing, if not preventing, contact of foreigners with its citizens. This traditional Soviet concern led to the specific problems encountered in the exchanges of the 1970's.

Thus, the scope and quality of the interactions under the 11 US- Soviet S and T agreements were affected by the following illustrative problems:

1. There were quaint(and often lengthy) Soviet delays in answering US communications and queries; in some cases the lack of a timely response related to a schedule and agreed upon action resulted in postponement or abandonment of a joint activity with detrimental consequences for the pace and scope of the intended cooperation.

2. The Soviets frequently deferred or canceled at the last minute project meetings and other joint activities; such Soviet action extended in the USSR to eliminating research institutes and other facilities from itineraries after the site visits had been worked out with, and agreed to by, the Soviet side in advance.

3. The Soviet regime severely limited access to its scientists and technologists, and to relevant information required by their US counterparts to promote meaningful cooperation; for example, progress was delayed or reduced when the US side did not receive from the Soviets timely data needed for project definition and implementation, or on completion of activity was supplied with Soviet reports containing inadequate information; in still other instances, the USSR would not allow many of its first-rate scientists and technologists to travel abroad to participate in joint activities.

4. The political limits on foreign travel by its citizens were exacerbated by USSR's funding problems; thus, the Soviet shortage of hard currency affected the duration of visits and reduced the number of Soviet scientists and technologists who could travel to and work in the US.

5. Internal jurisdictional problems between major Soviet science and technology agencies or ministries involved in US-Soviet cooperation were responsible for lack of progress in some instances; as long as these problems remained unsolved, they

caused delays in project implementation which led US scientists to drop out of a cooperative effort because of other professional commitments.

6. The Soviets occasionally attempted to dictate the choice of US participants; they did so by trying outright to bar the entry of some US scientists and technologists into the USSR, or by raising technicalities that had no bearing on the scientific capabilities of the US participants; on other occasions, the Soviets attempted to achieve the same effect of discouraging "undesired" US participants by delaying the issuance of visas until the US scientists and technologists themselves changed their travel plans and canceled their visits to the USSR (this effort was abetted by the fact that Soviet issuance of visas in general was, more often than not, a last-minute action).

7. Cooperative scientific-technological activities were affected by the science and, particularly, the technology gap between the US and the USSR. Because the Soviets lag behind the US in many areas, the interest of US scientists and technologists in cooperating with the USSR (particularly in long-term, joint research projects as opposed to brief visits and exchanges) was small when considered against the size and the potential of the two scientific-technological communities involved. The situation was compounded by the problem of identifying and gaining access to advanced Soviet theoretical work, greater experimental data or unique facilities as compensation for Soviet interest in and benefit from the generally superior US applied science and technology. The enthusiasm of US scientists and technologists for participating in joint projects was further affected by cumbersome administrative procedures and constraints; the latter were not offset for US scientists by looking forward to professionally rewarding substantive work, given the gap between the USSR and the US in many S and T areas. Indeed, many participating US scientists experienced difficulties in demonstrating to themselves and others the scientific worth of joint projects; this affected the willingness of others on the US side to participate in subsequent joint projects.

8. Many actual and potential US participants reacted negatively to USSR's harsh treatment of its dissident scientists and technologists; this attitude developed in some instances after US participants were personally confronted by a dilemma of how to respond to invitations to meet with Soviet scientists and technologists who were out of favor with their regime and who were barred from work at their former research institutes; some of these alienated Soviet scientists tried to maintain their professional skills by holding seminars in their apartments and inviting visiting US scientists to share their latest work at the so-called Sunday seminars; other dissident scientists tried to make individual contacts with US participants, confronting the latter with the possibility of being charged by the Soviet regime with "engaging in activities incompatible with US-Soviet scientific and technological cooperation"; but avoiding interaction with their alienated Soviet counterparts was against normal instincts of our scientists and technologists, particularly because many dissidents had done first rate work for which they were known through their earlier published work (as punishment, the Soviet regime eliminated from Soviet bibliographic documents references to and citations of the dissidents' scientific work.)

9. US-Soviet science and technology cooperation was also affected by an overriding internal Soviet precept: priority of Party and government control over efficiency. Because US-Soviet S and T cooperation infringed on such control, by opening up the system to US influence and thereby leading to imagined or real loosening of the Soviet regime's hold over its people, some cooperation was not allowed and other was tightly circumscribed. In these circumstances, fruitful interactions resulting from normal and direct contacts between US and Soviet institutes and individual scientists and technologies were not possible; in fact, the Soviet regime monitored and oversaw all contacts between Soviet and US scientific-technological personnel, even at the height of US-Soviet political detente in the mid-1970's. This approach affected the ability of Soviet scientists and technologists, whether at home or abroad, to share research results with their US counterparts. For example, Soviet scientists could not give drafts of working papers to their US counterparts without specific permission and lengthy delays, even when these papers arose out of collaborative effort. The attitude of US participants was further -affected by the inability of Soviet scientists and technologists to engage in other, normally accepted activities such as open and unfettered contacts outside official meetings, e.g., visits to homes. In sum, Soviet procedures affected the quality of exchanges and the willingness of US scientists and technologists to participate in US-Soviet S and T cooperation.

10. Finally, a key asymmetry between US and Soviet systems affected bilateral S and T cooperation. All Soviet scientists are state employees and therefore can be ordered by their government to engage in joint activities with the US. By contrast, US scientists work primarily in 'industry and universities and cannot be similarly

ordered to engage in such interaction. This asymmetry puzzled many Soviet officials and affected US-Soviet cooperation accordingly. Some US scientists, in protest of Soviet regime's treatment of its dissidents or on the basis of individual judgments about small benefit to be derived from cooperation, refused to participate in joint activities. The Soviets then ascribed such refusal to behind-the-scenes manipulation by the US government, since it was unthinkable to them that any Soviet scientist would refuse to participate if ordered to do so by his government. (Such a refusal by Soviet scientists was unlikely in any case for other reasons; more than their US counterparts, they were, and are, eager for joint work with the generally more advanced US S and T community.)

IMPLICATIONS OF THE ACADEMY'S ROLE FOR US-SOVIET EXCHANGES

The USSR Academy of Sciences is the most creative part of Soviet S and T and works on the leading edge of science which could benefit the US most. But, against the background of organizational fragmentation and lack of a unifying coordinating role entrusted to the Academy (noted earlier), the latter has lost its decisive role in Soviet science and accompanying political influence. In this connection, an overriding political fact to date should be noted: as an institution, the Academy has never had a genuine scientist-member on the Politburo. (By contrast, the military, the KGB, and even the Foreign Ministry had or have representation on this top ruling body.) Then, too, the GKNT has moved from an initial role in the 1960's of overseeing technology to also currently funding and monitoring applied science. Since the line between basic and applied science is already fuzzy in many areas, the Academy is suffering erosion of its sway by GKNT even in the area of its supposed jurisdiction, i.e., basic science.

The Academy's position in the recent past was weakened further by the Party's unhappiness on several counts. Even now, the Academy is the only major institution with great autonomy in the Soviet Union: it has and continues to elect its members routinely by a secret vote. In the past, the Academy provoked the Party's ire, particularly among the old ideologies such as Second Party Secretary Suslov, when it resisted the election of Party hacks (e.g. S.P. Trapeznikov) as Academy members who then acquired prestigious titles even if these were not significant politically. The Party's negative attitude was further heightened by sizable dissidence in the Soviet science ranks, which in the Academy's context was symbolized by its refusal to expel Sakharov from its ranks. This show of independence only increased the pressure within the leadership to bring the Academy to heel. Such pressure was highlighted by Party Secretary Suslov's several unprecedented appearances at the Academy in the early 1980's to deliver personally the Party's stern message on toeing its line. (The erosion of the Academy's freedom was best illustrated earlier by the regime's abrupt deferral of the Academy's 250th Anniversary Celebration from 1974 to 1975; this caused much embarrassment to the Soviet science community since in 1974 it had issued invitations to foreign guests and arranged elaborate commemorative ceremonies and events. More important, Party membership has become almost sine qua non for Academy membership and advance in its S and T hierarchy. Such Party membership subjects an Academy members not only to normal administrative control but also to Party discipline.

Equally important, the Soviet leadership's growing stress on applied science in order to improve and increase production has further decreased the Academy's influence. In the face of current and projected poor Soviet economic performance, manpower shortages, systemic problems (e.g., Party's control at the expense of efficiency) and other difficulties, the Academy could lose even more of its influence, particularly if it continues to advocate work on basic research as its prime interest.[7]

But any decrease in the Academy's role and capabilities has a direct bearing on long-term development of Soviet science and potential US-Soviet S and T cooperation and benefit to the US. Diminishing the Academy's capabilities would negatively affect the health of Soviet science, since the Academy. represents the most vital and creative part of the Soviet S and T community. Then too, since the Academy has been oriented heavily towards fundamental research, reducing its role in this area would affect the quality of basic research in the USSR with ensuing implications for future US-Soviet cooperation. In the 1970's US cooperation benefited significantly

[7] To be sure, Gorbachev has a different attitude about his predecessors. His close adviser is Academician Velikhov who is also known for leading USSR's high energy weapons research work. It is unclear how far Velikhov will or can go to retain the Academy's autonomy and basic research orientation. Gorbachev, in any case, has already said he expects the application of S and T to production to be Soviet science's primary goal. This means that the Academy has to adjust the Gorbachev's (and the Party's) views of priority for applied science and not vice versa.

from the Academy's advanced fundamental research in areas such as theoretical physics and mathematics. Consequently, any marked shift by the Academy to applied research where Soviet achievements on the whole have been meager, would reduce accordingly the benefits to US of any extensive cooperation with the Academy.

CONDUCTING US-SOVIET S AND T EXCHANGES TO INSURE US BENEFIT

Despite the Soviet substantive shortcomings and the procedural obstacles to normal exchanges noted earlier, the US can benefit from S and T interactions with the USSR. But for the US to do so and yet minimize unwanted technology transfer, bilateral exchanges should meet the following four general requirements. First, they must be properly arranged. For example, the US should: identify and select for exchanges S and T areas of Soviet strength and avoid areas of known Soviet weakness; avoid loopholes such as Article N of the 1972 Agreement which may give unwanted wide-ranging Soviet access to US industry; provide for direct access by US scientists to the best Soviet scientists and to first-rate Soviet research facilities, such as the advanced institutes of the USSR Academy of Sciences; minimize the need to deal with intruding bureaucratic layers of GKNT or Ministries; provide for equal and reciprocal exchange of data and working drafts; obtain for US scientists the freedom to travel within the USSR comparable to that enjoyed by Soviet scientists in the US, including attendance of internal workshops and professional meetings, and travel from host campuses to other universities, labs, and facilities.

Second, the bilateral exchanges must be properly administered and implemented. For example: mid-level US administrators should be qualified to negotiate, have in-field experience in the USSR, and have Russian language capability to avoid being in hands of Soviet interpreters and veteran "tech transfer gamesters;" participating US scientists should be required and obligated to provide results of their joint work with Soviet counterparts to US government so that it can build a record of experience and information base to draw on for historic comparison and comprehensive evaluation of gains and losses to US; this would complement the individual benefits derived by participating US scientists and institutions.

Third, given the intensive efforts of the Soviet regime to acquire military and dual use technology to date, the exchanges should be properly monitored. For example, the relevant US national security agencies should have adequate resources to monitor movements and activities of participating Soviet S and T personnel in US; and the US host institutions and scientists should be obligated to cooperate on reporting inappropriate activities of such personnel on their campuses or elsewhere.

Finally, the exchanges should be properly assessed. For example: after the scientific results of joint work are made available by participating US scientists and institutions, qualified analysis should evaluate such results on a continuing basis, and make available gains and-losses summaries in a timely fashion to US administrators and policy offices; in this connection, self-assessments of joint activities should not be carried out by participating US scientists, though they can and should contribute their views on the benefits and losses from of their specific projects.

In specific procedural terms, any proposed large-scale joint activity with the USSR should be pre-tested initially for likely US benefits, and only then implemented by the following illustrative steps. First, cooperation should be preceded by survey visits. The US scientists ordinarily should go to the USSR first, to ascertain in advance of large scale project work how much they will be shown and how far the Soviets intend to cooperate, before we open up our laboratories and expose our most capable people to Soviet "brain-picking."

The initial survey visits should, whenever possible, be followed up by long-term, in-field visits of individual scientists (of 3 months, or longer duration). Only then should these initial steps be capped by joint, multistage research projects that might involve US and Soviet teams at work for extended periods, alternatively in the US and in the USSR. Periodic assessments in the course of the joint work would allow judgments to be made about the desirability, in terms of US interests, of continuing the projects to conclusion.

The foregoing US policy approach and implementing procedures would minimize the intrusion in US-Soviet scientific exchanges, to US detriment, of larger Soviet political-military policies and procedures. Comparable US approaches and procedures applied to broader East-West technology interactions could similarly protect the US against a "one-way flow" in Soviet favor that it has experienced in the past.

US BENEFITS FROM US-SOVIET S AND T EXCHANGES

If the experience of the 1970's is taken into account, and the above requirements for proper arrangement, administration/implementation, monitoring and assessment of exchanges are met, the US can maximize benefits from such exchanges and minimize technology transfer losses with the following outcome. It can capitalize on the specific strengths and on the breadth of Soviet S and T research and development work noted earlier, even as it pursues the exchanges in full awareness of Soviet political and military goals. In the process, the US can improve its understanding of Soviet S and T policy, organization and cadres, and thereby better assess Soviet S and T weaknesses and strengths. To attain such an improvement is a desirable US goal: since the Soviets. know a lot more about US science because of the openness of our society, increased US knowledge would, conversely, help close the information gap and improve the quality of future exchanges, with resulting benefit to the US. Improved knowledge of Soviet S and T would also help us better answer why the massive input and high political priority given its S and T community by the Soviet regime have not been matched by the output of that community. (As noted earlier, such a deficiency is now freely and openly admitted by the Soviet political and scientific leaders.)

Finally, the interaction of US scientists with Soviet scientists can favorably influence the Soviet S and T community. The current asymmetry between the Soviet regime's investment in S and T and the output, suggests how the Soviet scientists "vote" their unhappiness via low productivity. Their unenthusiastic attitude is undoubtedly heightened by their contacts with Western scientists when the Soviet scientists learn about freedom in general, and scientific freedom in particular, outside Soviet borders. At the extreme, their unhappiness to date has been reflected in the significant fact that many of the Soviet dissidents are scientists. The continuing low morale and productivity of such a key Soviet group could ultimately force genuine moderation of USSR's policy toward the West. Thus, to make up for their own S and T deficiencies, the Soviets even now have to turn once again to the West. But to get a favorable response over the long run, the Soviets would have to pursue a sustained conciliatory policy toward the West. As in the past, the current conciliatory policy could turn out to be a tactical, short run move. Whether it is transformed into a permanent change would depend on larger factors such as maintaining the strategic balance between the USSR and the West and the latter's unity in containing the post-World War II Soviet expansive policy abroad. The current Gorbachev policies may be laying the foundations for such a basic change, though the concrete evidence is still to come.

CONCLUSIONS

This paper has noted scientific-technological exchanges as a unique form of technology transfer and commercial relations that entail two-way human interaction. It also reviewed and analyzed the US experience of bilateral exchanges with the USSR in the 1970's. The procedural and substantive requirements for future exchanges, to insure US benefit and minimize undesired technology transfer were spelled out. Also detailed were the expected gains for the US from properly arranged exchanges.

From these observations, it can be concluded that the Soviet drive for technology transfer detrimental to US interests can be transformed, in the S and T exchanges context, into US benefit by properly fashioned joint activities. Moreover, the low productivity of Soviet scientists to date, despite massive material infusion and high political priority, can doubtless be further affected by contacts with their Western counterparts in activities such as S and T exchanges. Since the Soviet leaders willy nilly have to count on their S and T community to help modernize USSR's economy and develop its weapons systems, they may be forced to respond with fundamental systemic reform to the attitudes underlying the low productivity of their scientists and reflecting the impact of interaction with US scientists. One accumulating impact relates to desire of Soviet scientists to participate in normal international S and T activities, including untrammeled freedom to travel abroad and have unrestricted contacts with Western scientists at home, as well as to be freed from constraints on exchanging research results.

If the pressure of Soviet scientists for such freedom produces a more open relationship of the USSR with the outside world, it would help reduce US concern over technology transfer damaging to its interests. For, such a relationship could make it more difficult for the Soviet regime to hide any S and T effort devoted to military purposes, as has been and still is possible under the controls the USSR has applied to date on interactions of its people with the West.

Indeed, a more open S and T relationship with the West could serve as a significant step toward opening up the USSR in other key areas such as arms control, e.g., expanding on-site inspection beyond the first steps in the INF Treaty, and thereby relieving still further the current concern over East-West technology transfer in the US. In turn, such developments could serve as long run steps to improving the larger US-Soviet relationship, and expanding US-Soviet commercial relations.

In sum, broader and more open US-Soviet S and T relations could lessen not only technology transfer concerns, but also help reduce tensions in strategic arms relationship, an area both nations consider vital to their very existence. Whether such openness in S and T exchanges develops will depend, of course, on whether the Soviet regime, partially in response to its S and T community's desire for greater freedom to interact with the West, makes fundamental systemic changes that open up Soviet society to normal intercourse with outside world, e.g., lifting censorship and travel restrictions, and easing the normal compartmentation of Soviet people, including scientists, affecting each other as well as foreigners. Such societal openness has not been traditional either in Zsarist Russia or the USSR to date. But since it is the heart of international S and T lifts, it would, if introduced in the Soviet Union, relieve the immediate concerns of the West, related to undesired technology transfer that adds to Soviet military strength at US expense. In the long run, such Soviet societal openness—forced in part by S and T developments that are eroding secrecy and control of data by a few, e.g., the "information explosion" in the personal computer, microelectronic era now underway[8]—could also affect USSR's goal of undermining the Western world that has been at the core of Soviet policy since 1917. US-Soviet S and T exchanges could contribute significantly to such a fundamental change in the Soviet system and its expansive policy abroad. In turn, this could also affect the quality and scope of US-Soviet commercial relations, since to date trade has followed the flag in US-Soviet relations.

Prepared Statement of Roger Robinson

Economic and Financial Security: Gorbachev's Perestroika and How the West Should Respond

Introduction

One of the most important security challenges now facing the West is the need to define and pursue a coherent and security-minded policy approach to Mikhail Gorbachev's announced program to "restructure" the Soviet economy. Such a policy approach requires an accurate understanding of what perestroika is today. If it is other than the advertised, wholesale reordering of the USSR's budget priorities—if it entails less than a fundamental and irreversible reallocation of resources from the military to the civilian sectors, perestroika's benefit to the United States and its allies will be greatly reduced. Indeed, under such circumstances, "economic restructuring"—with the help of Western governments, commercial banks, and businesses—will serve principally to make the Soviet Union an economically stronger and more dynamic adversary.

This paper offers means for judging the true character of perestroika. It also makes recommendations for a coordinated alliance policy in light of the actual nature of Gorbachev's present approach to "restructuring." These are designed to ensure that the West does not provide material assistance to the USSR in ways inimical to vital Western security interests. If implemented, they will also assure that such assistance as is provided helps to effect the kind of perestroika which advances genuine economic reform within the USSR and reduces the Soviet threat to the Free World.

Assessing the Soviet Economic and Financial Challenge Facts and Discussion

Mikhail Gorbachev is anxious, even desperate, to enlist the West in his campaign to resuscitate the stagnant Soviet economy and those of his allies. His efforts have met with considerable success as Western Europe, Japan and, increasingly, the United States are proving receptive to the USSR's requests for large hard currency loans, credit lines, joint ventures, technology transfers and privileged access to

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[8] For a detailed assessment of the probable impact of these technologies on the USSR, see The Impact of Information Revolution on the USSR (Richard F. Staar, ed.), Hoover Institution, Palo Alto, CA, 1988.

Western markets. The question is: What is this perestroika the West seems so ready to support?

Defining Perestroika

Perestroika has come to mean many things to many people. While Western interpretations and Soviet propaganda most often paint an optimistic view, seeing economic restructuring as a potential blueprint for dismantling the command economy and totalitarian rule, the facts suggest otherwise.

There is no evidence to date—Moscow's rhetoric notwithstanding—that "economic restructuring" as practiced by Gorbachev has yet entailed dramatic and irreversible change in of the following areas:

—the systematic growth in annual military expenditures;

—the offensive character of the Soviet Union's armed forces and military strategy;

—genuine market-oriented economic reform;

—disregard for fundamental human rights despite obligations under the Helsinki Accords;

—maintenance of an aggressive, global empire;

—glasnost notwithstanding, the lack of transparency in Soviet society and key data disclosure in the civilian or military sectors of the Soviet economy; and

—the systematic and illegal acquisition of militarily relevant Western technology.

Bottom Line.—As currently configured, Gorbachev's perestroika amounts to an attempt to have it all ways, without having to face hard choices in reallocating resources away from the military sector and support for global adventurism to the civilian economy.

—The West is helping to finance simultaneously an expanding military budget, the maintenance of aggressive foreign activities and the resuscitation of a failed Soviet economy.

Why the Soviets Urgently Need the West's Assistance

The costs of a global empire in terms of hard currency, technology and equipment transfers, and management are increasingly unsustainable for the USSR due to:

—impoverished allies and client states;

—declining prices for the narrow base of Soviet exports, especially oil and gas which comprise roughly 75 percent of Moscow's annual hard currency income which amounts to a mere $32-37 billion;

—increasing difficulty in meeting the military's requirements for advanced technology; and

—demands for improvements in domestic living standards through large infusions of Western consumer goods and other items.

Bottom Line.—Virtunlly all of the USSR's annual hard currency earnings are required just to purchase imports from the West and to service its debt.

—Assuming its earnings are earmarked for these too purposes, the West through undisciplined lending practices unwittingly financing a large portion of the Soviet empire's remaining hard currency requirements at a multibillion dollar annual cost to U.S. taxpayers.

The West: Moscow's Ace in the Hole?

Consistent with past occasions when the USSR faced such grim economic and financial realities, the Soviets are, in effect, turning to the West to bail them out.

—Western lending and technology transfers are, ironically, not advancing the success of perestroika as it should be defined.

To the contrary, such activities are permitting the USSR to avoid or defer most of the painful decisions real economic restructuring would require and hence are actually retarding genuine reform.

—In fact, Soviet exploitation of such external economic and financial assistance is of critical importance in preserving the totalitarian nature of the Soviet system and sustaining its global commitments as currently structured.

—Unlike previous periods of economic crisis, however, the Soviets do not have the same flexibility to maintain the competitiveness of their system and the preeminence of their military power by simply demanding ever greater sacrifices of the Soviet and East European populations.

High technology cannot be generated by depriving the Soviet citizenry of goods and services as was once the case with steel, concrete and other commodities.

This reality has become more acute as perestroika has increasingly entailed destructuring of the civilian economy. Soviet consumers are, if anything, worse off as a result of the dislocation and uncertainty afflicting non-military production and services.

Instead, high technology—and the hard currency to acquire it—most often must come from Western sources.

The Soviets are determined to obtain such technology through legal transfers and massive illegal acquisition efforts.

Bottom Line.—Increasingly, the political costs to Soviet leadership associated with depriving soviet consumers is on the rise and the value of those sacrifices in keeping pace with prodigious Western technological development is diminishing.

Misquided Assumptions Can Make for Dangerous Policies

The Anglo-American tradition assumes that trade is automatically a pacifier, that one's adversaries can be transformed—at best, into partners, at worst, friendly competitors—by the entangling ties of commerce and finance.

—In fact, during the detente of the 1970's and similar periods in the past, the Soviets have shown that they are perfectly prepared to obtain Western economic and financial assistance and engage in military build-ups and aggressive foreign activities.

Many in the West believe that, absent large-scale Western economic and financial assistance, Gorbachev's position as an attractive, "moderate" reformist would be jeopardized by "hard-liners" in the Politburo.

—As then President-elect Bush correctly stated in an interview published on 8 November 1988: "It's not clear to me that we understand the dynamics of the Soviet system well enough to know how to help Gorbachev even if we determined that we wanted to. And since we're not sure of our understanding of the mechanism of change, we must stick to the fundamental guiding principle of sensible foreign policy: pursuit of our own interests."

The soviet Onion is regarded as a sound and attractive credit risk at a time when there are relatively few creditworthy sovereign borrowers (due to the ravages of the international debt crisis) and when other creditworthy sovereign borrowers have taken to issuing their own securities to meet funding needs.

—The long-term creditworthiness of the Soviet Union as perceived by Western banks, however, is often predicated upon several misconceptions, such as:

Abundant gold reserves: In fact, the soviets cannot afford to tap these strategic reserves (estimated at $30-35 billion) lest they set off a panic in the metals markets and a widespread perception of Soviet financial desperation.

Deposits in Western banks: The extent to which Soviet deposits in -stern banks (estimated at $13-15 billion) could be, in part, recycled western deposits in Soviet banks is far from clear. Such unseen deposit flows could occur through the inter-German financial corridor and non-reporting banks and governments in the Middle East. Soviet deposits could also disappear rather quickly during periods of political tension or liquidity problems.

Large-scale reserves of oil and gas in the around and off-shore: In many cases, it is not possible for the soviets to extract, process and transport these assets without heavy investment by western partners.

—For example, drilling in permafrost and in deep off shore waters in the Arctic are simply beyond present Soviet capabilities and resources.

—Moreover, such Western assistance could easily contravene the spirit—if not the letter—of several existing alliance agreements which, in effect, limit Soviet gas deliveries to Western Europe to 30 percent of total West European gas supplies.

The Soviets' hard currency loan portfolio to Third World countries: In fact, the real value of this loan portfolio (estimated to be roughly $50 billion)—and its potential collectability—are vastly overstated.

—This portfolio may, in reality, be worth no more than 20-30 cents to the dollar, if that much. The bulk of these Soviet credits were to fund arms sales to impoverished client states which undoubtedly were not expected to repay these loans. These Soviet arms credits were likely funded, in part, by borrowings from the West.

Diversified base of exports: The Soviet onion has demonstrably failed to diversify its base of exportable goods. Its exports consist essentially of only four items: oil, gas, arms and gold. Sales of these comprise 80-90 percent of the USSR's entire annual hard currency income.

—The Soviet Union cannot control world energy prices; therefore the bulk of annual Soviet hard currency earnings are, by definition, highly volatile.

—Liquidity problems among traditional Middle East purchasers of Soviet arms and the emergence of competitive new arms suppliers (eg., Israel and Brazil) have limited the Soviet ability to expand global arms sales as a means of bolstering hard currency income. In any event, it is not in the West's interest to have the Soviets expand their arms sales to the developing world.

—Finally, as noted above, the USSR's ability to expand significantly its export of gold bullion is constrained by highly sensitive market forces.

The USSR appears to have an abundance of potential consumers with a theoretically large appetite for Western goods and services; banks wish to position themselves for an anticipated increase in corporate business.

—First, it is highly unlikely that the USSR will permit its domestic market (to the extent it allows a consumer market to develop) to be fully open to Western imports and business activity. Indeed, Western access to the Soviet market could easily remain "on the fringes" and carefully controlled.

—Second, the Soviet market will probably remain a very small percentage of the total volume of annual Western exports, particularly when compared to markets such as the Far East or even Latin America.

Business with the Soviets is, at the moment, good politics.

—Several West European governments are touting the importance of "helping Gorbachev" and encouraging various means of doing so such as: guaranteeing credits, greater EC/COMECON integration, and the proposed dismantling of several categories of export controls on high-technology, etc.

—The unusual opportunity to appear to be supporting improved superpower relations while pursuing of its is too good for most capitalists to pass up.

—Historically, however, such political conditions have proved ephemeral; when the mood turns sour, businesses are frequently caught in the middle and either lose their front-end investments or find them encumbered for long periods of time.

To the extent a risk that the market will turn sour (either for political or economic reasons) concerns them, most Western businessmen and bankers expect their governments to bail them out—either overtly (e.g., $2 billion of U.S. taxpayer money lost in Poland through Commodity Credit Corporation guarantees and Eximbank guarantees) or through more subtle mechanisms.

—In either case, such bail-outs will almost certainly come at the taxpayer's expense.

The prospect of banks invoking the considerable ire of Western taxpayers and the Congress—when the former are obliged to absorb the risk (e.g., government guaranteed loans) and potential costs of doing business with the Soviet bloc—should be a disincentive to large-scale Western investment in and lending to the communist bloc.

Although the United States is currently prohibited from offering government-guaranteed credits to the USSR, U.S. banks would be wise to lay low on lending to Soviet bloc countries in light of the growing outrage in the United States over a possible $100 billion federal bail-out of 0.5. savings and loan institutions, the implications for taxpayers of the international debt crisis, and the potential downside risks associated with bank-financed leveraged buy-outs.

—Interestingly, the majority of Western loans to Warsaw Pact countries take the form of the same kind of untied, general purpose lending that was one of the principal causes of the current $1.3 trillion international debt crisis.

—If the Third World debt crisis were not enough to dissuade banks and other would-be creditors from doing still further undisciplined lending to sovereign borrowers, the practice is strongly discouraged in the lead recommendation of a June 1987 report of the banking industry's own Institute for International Finance. (This organization counts among its members over 180 of the world's leading commercial banks).

Allied lenders are, nonetheless, rushing to encourage Soviet borrowing. Although no precise numbers are available, Japan's share of the volume of new lending to the Soviet bloc countries over the past four years is estimated to be as high as 40 percent. Western Europe and the Middle East were together responsible for roughly 57 percent, compared to the U.S. share at about 2-4 percent (if off-shore lending and interbank deposits in Soviet-owned banks in the West are included).

—Importantly, however, over the past six months, the Japanese government and banks have shown considerably more prudence and caution in their financial relations with the Soviet bloc countries. They have appreciated far better the solid commercial and security-minded reasons for doing so than have their counterparts in Western Europe—especially the Federal Republic of Germany.

Bottom Line.—The creditworthiness of the USSR and Eastern Europe is a more complex calculation than many banks and companies realize. The inadequacy of soviet annual hard currency earnings should assume primary importance in the credit decisions of Western banks and governments—particularly given that Gorbachev wants what few hard currency-earning enterprises and Ministries the USSR does have to become entirely "self- financing."

The West Should Look Carefully Before Leaping

The USSR is not just another candidate for Western economic and financial assistance; it is a special case requiring exceptionally cautious treatment.

—The Soviet system and command economy are fundamentally incompatible with the respect for the values and rights of the individual that is the cornerstone of Western democracy and the free enterprise system.

—In reality, there is no moral equivalence. No amount of lip-service paid to solving "human problems in a humane way" can eliminate the basic inhumanity of Soviet communism.

A particularly egregious example of this inhumanity is the Soviet Union's use of forced labor to produce certain export goods.

—Similarly, the large Soviet command economy is simply incompatible with the market-oriented philosophy underpinning these institutions (e.g., GATT, IMF, World Bank, Asian Development Bank, etc.).

Moreover, the Soviets have historically used their membership in multilateral organizations (e.g., the United Nations) for disruptive purposes when doing so suits their political objectives.

—Particularly noteworthy in this regard has been the USSR's practice of encouraging Third World countries to oppose sound economic policies advocated by the industrialized West and to repudiate their debts to Western banks and governments.

The Soviet Union continues to represent a determined and formidable adversary, which fields today more potent armed forces than during the pre-Gorbachev period.

—Its military might—even after promised unilateral force reductions are made—will vastly exceed any legitimate defensive requirements and maintain Soviet conventional superiority of about 2.5 to I over NATO forces.

It cannot be over stressed that the preeminent beneficiary of Soviet efforts to acquire Western technology and hard currency remains its armed forces and military infrastructure.

Soviet intelligence and active measures are operating on an expanded basis in the era of glasnost and renewed detente.

Bottom Line.—The Soviet system is, in fundamental ways, at odds with that of the Western world. Ignoring the differences, seeking to paper them over or otherwise minimizing their significance in the hope of short-term profit, can seriously jeopardize the West's long-term security interests.

The Soviets' Ambitious Economic Offensive

The Soviets are, nonetheless, aggressively encouraging just such an approach throughout the West. Thanks to innovative diplomacy, relentless propaganda, much improved marketing, and an adroit ability to promote and exploit Western willingness to "help" him, Gorbachev is poised to effect a penetration of Western economies and societies without parallel in the post Revolutionary period:

—Floating Soviet bonds and other securities allows Moscow to recruit Western securities firms, pension funds, insurance companies, corporations and even individuals as lenders of untied cash to the USSR for the first time.

Over time, thousands of Western non-banks and millions of Western citizens could be wittingly—or unwittingly—holding Soviet paper in their bond portfolios and pension funds.

These new and politically influential constituencies would have a vested financial interest in supporting continued Western economic and even political concessions to the USSR.

Another advantage of this device is that Western non-bank credit exposure to the USSR is not currently recorded as adding to the total indebtedness of the USSR.

—This type of potentially "invisible" borrowing is but one example of the ways in which actual currency flows to the USSR can be in excess of those officially reported.

—At some point, the West cannot afford to be indifferent to the dangers of reverse leverage from outstanding Soviet indebtedness. While experts can differ as to when that point might be reached, planning for such a contingency should begin in the near-term.

Conventionally accepted figures indicate that Soviet indebtedness has roughly doubled over the past four years to around $45 billion. This gross debt figure, however, does not include as much as $5–10 billion in Western bank deposits (which should be considered untied loans) in Soviet-owned banks located in the West. Total Soviet bloc indebtedness has risen to roughly $140 billion.

—The dearth of creditworthy sovereign borrowers has led to a Soviet buyer's market which Moscow has skillfully exploited. As a result, the Soviet Union has se-

cured billions of dollars in untied cash from the West since 1985 at interest rates as low as 6 3/8 (e.g., the 7-year Soviet bond floated in July 1988).

Soviet untied borrowing (and that of Bulgaria and Czechoslovakia) from the West in 1987 was at an average interest rate of only about ⅛ of 1 percent over the cost of funds (London Interbank Offered Rate) on 8-year maturities.

—An effort is underway to overturn existing U.S. legislation which currently prevents equal tariff treatment for Soviet imports and denies Soviet access to Eximbank credits and guarantees (i. e., Jackson-Vanik, Stevenson, and Crane amendments).

—Joint ventures (an activity virtually unmonitored by the U.S. government and rife with opportunities for illegal technology transfer) are being actively promoted by the Soviet Union.

Such ventures offer yet another means of obtaining potentially unrecorded Western lending under the guise of "equity contributions."

The Soviets are utilizing the following devices to promote joint ventures: revised ownership requirements; a treaty reflecting tax code revisions; and an investment protection agreement.

—The Soviets are also pursuing access to U.S. stock and capital markets; a key target for those who seek to "help Gorbachev," consequently, is the Johnson Debt Default Act of 1934 which, at present, prevents such access.

—Foreign investment in the United States offers the Soviets extraordinary opportunities to circumvent U.S. technology security laws by acquiring equity positions in high technology firms or banks.

Such investment is poorly monitored by the U.S. government.

—A Soviet-orchestrated effort is also afoot to persuade West European countries to ignore the International Energy Agency Agreement of May 1983.

—This agreement, in effect, prevents future Soviet domination of West European gas markets in favor of secure Norwegian and other Western supplies.

—Unmonitored visits by Soviet and Warsaw Pact individuals to the United States also afford significantly expanded opportunities for industrial and military espionage.

In December 1988, there were 6500 unescorted visa holders from "hostile" countries visiting the United States.

—These visitors represent an unsupportable counter intelligence task given present FBI resources.

—The Soviets have already penetrated certain international economic and financial institutions (e.g., Pacific Basin Economic Cooperation Council, the Asian Development Bank, etc.) They aspire to enter most, if not all, the remaining organizations in the near future.

Ominously, membership in such organizations involve largely "irreversible" concessions to the Soviets.

By contrast, most (if not all) of the steps the Soviets are taking that are said to justify such "help" are eminently reversible.

This fact suggests that, unlike some other areas of the economic and financial security portfolio, the adverse imbalance in benefits enjoyed by the West relative to those obtained by the East will be permanent.

What is more, the Soviet bloc's penetration of the Western economic and financial structure on very generous terms will almost certainly breed resentment among less favored hemispheric and other developing friends and allies.

Simply put, democracies of Latin America and elsewhere are unable to obtain comparable low interest rates, preferential debt rescheduling arrangements (e.g., Poland), government-guaranteed credits and access to Western capital.

—As a stimulus to commercial lending to the East, Western governments have shown themselves willing indeed, eager—to provide government guarantees on credits which transfer the risk of any future Soviet bloc country debt rescheduling or default from the banks involved to Western taxpayers.

Such government guarantees also artificially lower interest rates as commercial banks price the loans on the basis of "Western government risk" as opposed to, for example, "Soviet risk."

—Not only are developing countries outside the Soviet bloc unable to enjoy such felicitous treatment; in many cases, they are simply unable to obtain new loans at virtually any price. In fact, if they can attract new loans, they are obliged to conform to strict requirements for documenting the use of such funds—most often under the aegis of IMF-supervised adjustment programs.

Bottom Line.—Despite a sense of justified unease and mounting concern on Capitol Hill (as manifested, among other things, by the passage of two, virtually unanimous senate resolutions in the past seven months), little has been done by the exec-

utive branch of the U.S. government or by the United States' allies to develop a more disciplined and cautious response to the burgeoning penetration of Western economic and financial systems by the soviet bloc.

—What is worse, throughout its last two years in office, the Reagan administration consistently resisted any high-level consultations with the allies on the national security dimensions of Western credit flows to Warsaw Pact countries and client states—compounding already serious alliance disarray in this area.

POLICY RECOMMENDATIONS

Insist on True "Perestroika"

True perestroika—i.e., peaceful economic restructuring worthy of cautious Western support—would, in practice, be quite different than what is afoot in the soviet onion today. Such restructuring must entail:

—Dramatic and consecutive annual reductions in Soviet military expenditures;

A concomitant, across-the-board shift in the Soviet force structure from an offensive to defensive posture;

—This should result in a military establishment no larger than needed to provide a bona fide, non-offensively oriented defense of the USSR;

—Inclusion of true democratic pluralism in political reforms;

—Adoption of price reform for all segments of the Soviet economy, broad economic and military data disclosure and other evidence of a commitment to a more market-oriented economy;

—Compliance with the Helsinki human rights accords;

—The divesting of resource-draining client states, an end to regional aggression and to inordinately large arms shipments to truculent proxies like Nicaragua;

—Full transparency in all financial dealings with the West; and

—Cessation of "active" intelligence measures and the illegal acquisition of Western technology.

Bottom Line.—The substantially increased Western leverage that accompanies Moscow's urgent need for large-scale infusions of Western capital, technology, management, marketing skills and access to Western markets, should be used constructively to advance Western security goals, genuine economic reform within the USSR, and greater autonomy for Eastern Europe.

—The objective should be to change the direction of perestroika so that it means something that it does not today—an inward-looking and peace-loving Soviet Union.

Genuine "Help" for Genuine "Perestroika"

The United States should take the following steps, in concert with' its allies, aimed at "helping" the soviets effect the preceding, real reforms:

—Promote full data disclosure for all Western financial flows to Warsaw Pact countries and Soviet client states, including historical data covering the period 1978 through 1988.

U.S. companies, banks and organizations doing business with Warsaw Pact countries and Soviet client states should help lead this multilateral effort with voluntary disclosure practices.

It should be established for the record which Western firms or banks are doing what transactions, with whose money, under what terms, for how long, and for what purpose.

—In this regard, special emphasis should be placed on closing data gaps concerning financial transfers (bonds, notes, commercial paper, equity in joint ventures, "private placement" loans, deposits in Soviet bloc-owned banks, inter-German financial flows, etc.)

—Similarly, there should be public disclosure of the membership and management of the US-USSR Trade and Economic Council (USTEC). A determination should be made whether this organization is to be deemed a public or private sector institution.

—Gross figures on West-to-East financial flows should be publicly provided, not just figures net of repayments and exchange rate effects—as is the Treasury Department's present practice.

—Urge enterprises doing business with the USSR to subscribe to established principles such as those advocated by former soviet dissident Vladimir Slenak relating trade and financial practices to respect for human rights.

—Urgently pursue an alliance policy on the security dimensions of credit flows and the phasing out of all forms of untied, general purpose lending (e.a.. bonds. syndicated credits. other securities).

To date, the United States has chosen not to engage its allies on such issues, to say nothing of attempting to persuade them of the folly of undisciplined sovereign lending.

—Unfortunately, American leadership seems to be required if other Western nations and lenders are to be dissuaded from making commercially unsound loans to the Soviet bloc.

—Such U.S. leadership is particularly needed with regard to the fact that untied credits can be diverted much more flexibly and economically to fund activities inimical to vital Western security interests than is the case with traditional, disciplined loans.

In view of this deplorable lack of leadership, the Reagan administration's contention that there already exists an agreed alliance policy on lending to Warsaw Pact countries (stemming from the Toronto Economic Summit) should not be taken seriously.

—The so-called "no-subsidies, sound-commercial-basis alliance agreement" reported as the consensus of the participating nations in the Toronto meeting in fact, represents nothing more than "talking points" drafted by the United States at working levels before the Summit.

—It was never discussed by alliance leaders; the statement was issued, nonetheless, at the conclusion of the Summit and represented to be an adopted "policy."

—In any event, the document is seriously deficient. It in no way addresses the complexity and profound implications of this family of economic and financial security issues and, therefore, is of little value either as a statement of policy or as guidance to participating governments.

—Consequently, economic and financial security issues must be centerpieces of the agendas for both the OECD Ministerial in April 1989 and the Paris Economic Summit in July 1989. The key tenets of the resulting alliance policy should be:

All government guarantees and insurance facilities should be eliminated for Western loans to Warsaw Pact countries and soviet client states insofar as such measures expose Western taxpayers to risk which properly should be assumed solely by private banks and enterprises.

It should be stipulated that lending is "untied" unless Western lenders employ long-established lending techniques designed to ensure that borrowed funds are dedicated to specific, verifiable and desirable end-uses (i.e., non-strategic trade transactions and projects).

Techniques utilized (and documented) to tie Western lending to the Soviet Union should include:

—Strictly matching the maturities of loans to the duration of the underlying trade transactions or projects (e.g., a maximum 180-day loan for grain purchases—not three years);

—Restricted draw-downs on loans for projects or joint ventures (e.g., on-site inspection by independent Western experts to ensure that the progress of the project or joint venture warrants the next disbursement under the loan agreement);

—Increasing use of collateral;

—Export finance techniques which ensure that loan proceeds never leave the Western bank involved, much less the Western country; and

—Shipments made payable under letters of credit and other documented methods.

The OECD, together with the Economic Committee of NATO, should supervise and monitor the multilateral, voluntary adoption by Western banks and governments of greater discipline and transparency (through measures outlined in this paper) in their lending practices toward Warsaw Pact countries and Soviet client states.

—There are several major precedents in the 1980's for the OECD successfully performing these functions, even in instances where the U.S. share of the activity in question was zero (e.g., the International Energy Agency agreement of May, 1983).

—There is, likewise, precedent for the Economic Committee of NATO to conduct studies in parallel to those of the OECD and to reinforce agreed OECD policies through such means as communiques issued following NATO ministerials (e.g. that of June, 1983).

The allies must be persuaded that undisciplined lending adds directly to the United States' and Western defense burden and will be regarded accordingly by the Executive and Legislative branches when scarce U.S. resources are being allocated and budget deficit-reduction measures are considered.

—As an essential first step toward fashioning a common alliance policy toward undisciplined lending to the Soviets, terminate the State Department's current, secret negotiations with the Soviets aimed at effecting a quick settlement of defaulted czarist bonds.

Resolution of this matter would enable the Soviets to float bonds in the U.S. market for the first time. By definition, such Soviet bond sales would constitute untied, general purpose borrowing by the USSR, which is, as noted above, currently prohibited pursuant to the Johnson Debt Default Act of 1934.

—Oppose further debt rescheduling for Cuba, Nicaragua and other Soviet proxies so long as they are engaged in regional aggression, narco-terrorism, abuses of human rights or other misdeeds.

Cuba reportedly expects shortly to accomplish its fifth consecutive debt rescheduling since 1980.

—In fact, U.S. allies are already effectively subsidizing Cuba by continuing bilateral trade, despite routine Cuban failure to make repayments either in kind or in cash.

—Resist providing any irreversible Western economic and financial benefits except in return for appropriate, irreversible steps on the part of Warsaw Pact countries and Soviet client states.

For example, Soviet entry into the GATT in exchange for possibly ephemeral modification of emigration levels from the USSR or modest economic reform measures should be opposed.

--Level the economic and financial playing field between Warsaw Pact countries and Latin American debtor nations so that potential adversaries cease to enjoy preferential treatment (such as Western government guaranteed credits, more favorable terms and conditions on loans and multi-lateral economic conferences) vis-a-vis that available to fledgling democracies in this hemisphere.

—Improve U.S. Government monitoring of and reporting on developments bearing critically on the economic and financial security portfolio of the United States, particularly those resulting from the activities of the companies and banks of alliance countries (eg., the Libyan chemical weapons facility).

The latest so-called interagency report released by the U.S. government concerning Western lending to the Soviet bloc and client states, dated 7 November 1988, represents a superficial analysis with almost no attention paid to the security-related concerns outlined in this paper.

—What is more, the report contains major omissions and inaccuracies; a remarkable example of the latter can be found in the statistics claiming a dramatic shift back to tied lending in the first five months of 1988.

—That said, it is nonetheless striking that even this report (which was actually prepared essentially by the Treasury Department, alone) acknowledges that between 1983 and 1987, untied loans averaged about 80 percent of the total volume of Western lending to the USSR.

A new, in-depth report is urgently needed, highlighting national security concerns and rigorously testing whether loans are tied or untied.

—Require before-the-fact reporting of any planned Soviet and other Warsaw Pact country acquisitions in the United States, including banks.

—Limit U.S. visas issued to individuals from "hostile" nations to an appropriate fraction of the counter intelligence manpower and resources available to monitor their activities in this country.

Bottom Line.—The portfolio of economic and financial security policies should be integrated into all major discussions between the Bush administration and the Congress and between the United States and its allies in connection with upcoming consultations and decisions regarding:

—alliance defense burden-sharing;

—the international debt crisis; and

—U.S. budget deficit reduction.

There Will be a High Price Should the West Fail to Adopt Sound Economic and Financial Security Policies

Real—if as yet ill-defined—costs will likely accompany continued Western inattention to the Soviet economic and financial offensive:

—An opportunity cost, over time, of tens of billions of dollars in additional U.S. defense and foreign assistance expenditures will probably result from what amounts to preferential and undisciplined Western economic and financial assistance to the Soviet bloc.

—The West will, moreover, miss an opportunity of potentially enormous strategic significance if it fails to give impetus to real perestroika—constructive reform and movement of Soviet resources away from military spending and global aggression.

Bottom line.—Such costs vastly exceed the relatively modest and ephemeral material benefits likely to accrue—if, in fact, any do—from proceeding with the West's present, undisciplined financial and economic policies vis-a-vis the Soviet bloc.

Wither the Bush Administration?

There is some evidence that the Bush administration may take a more sophisticated and visionary approach to economic and financial security issues than did the Reagan administration in its second term.

—The strong bipartisan consensus in the Congress, along with extensive media coverage, seems to have persuaded several key figures in the incoming Bush administration of the need for a change in approach.

—This high-level group appears to regard adoption of alliance-wide economic and financial security policies as a necessity in light of anticipated cuts in U.S. defense spending and major shortfalls in alliance defense burden sharing (e.g., the lack of allied support for the modernization of short-range nuclear and conventional forces).

—President George Bush, National Security Advisor Brent Scowcroft, Deputy National Security Advisor Robert Gates, CEA Chairman Michael Boskin, and State Department Policy Planning Staff Director Dennis Ross have all acknowledged serious national security concerns associated with undisciplined Western credit flows to Warsaw Pact countries and undue Western government involvement in "helping" Gorbachev.

In the past, however, then Secretary of Treasury James Baker (along with then-Secretary of State Shultz) forcefully opposed high-level alliance consultations aimed at promoting coordinated and security-minded alliance policies in this area.

—At this writing, it is unclear whether Secretary of State Baker and the Treasury Department will continue to oppose ministerial and summit consultations aimed at forging much-needed alliance policies in the economic and financial security arena.

—In a hopeful sign, however, Secretary Baker did aver in his recent confirmation hearings that he favored greater transparency in East-West economic and financial relations. But this step falls far short of fully addressing this highly complex family of strategic issues.

Bottom line.—The jury is still out on the direction that the Bush administration will take in its response to perestroika.

—The high stakes for Western security require that the new President and his team make the adoption of a more disciplined and prudent approach to economic and financial relations with the Soviet bloc one of the first goals of the "comprehensive reassessment" of aS. foreign and defense policy upon which they have just embarked.

Trading With the Communists

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By Adlia E. Stevenson and Alton Frye *

In Moscow bold minds are asking where Marxism-Leninism went wrong. Were its premises flawed? Was the execution inept? Communist governments are experimenting with the answers. Americans would do well to pose similar questions about U.S. economic policy toward these nations. Are the premises correct? Do changes in their policies require new assumptions and changes in our policy?

The candor of Soviet self-criticism demands a comparable dose of introspection on our part. We have never expected mea culpas from the Soviets, and We have always prided our selves on a capacity for self-correction. Yet the United States has been slow to acknowledge evident shortcomings in its economic policy toward the Soviet Union and other communist countries.

Policies framed to deal with an expansionist imperial state driven by authoritarian ideology and marked by the sacrifice of its citizens' well-being to the appetites of its military establishment are not appropriate for a state being reshaped in the image projected by the architects of perestroika and glasnost. As evidence mounts that the reforms of Mikhail Gorbachev are real, the West is challenged to rethink its approach to the Soviet Union. If the international aggrandizement of Stalin and Brezhnev gives way to genuine restraint abroad and gradual democratization at home, it would ill serve the interests of the United States to play the implacable antagonist, blinded by preconceptions and paralyzed by inertia and timidity. The

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United States would begrudge the revolutionary changes in Soviet behavior which it had long demanded.

Even without such dramatic departures by Moscow, there is ample reason to reexamine Washington's policy. The United States could scarcely have blundered more often if it had followed a slapstick script. Over the past 15 years American policy has continually undercut its political objectives, harmed its economic interests and eroded its leadership in the Western alliance.

This pattern is partly attributable to the difficulties of dealing rationally with a state perceived as a powerful, atheistic enemy seeking world domination. Suspicious of Moscow's motives, Washington has not been inclined to give the Soviets the benefit of any doubt on important questions. U.S. laws still reflect an assumption that the Soviet Union reigns over a monolithic bloc of communist countries in a world divided by ideology and geography into two hostile camps. A fear of the worst—not always unrealistic—has blinded the United States to changes already made and failures self-inflicted. Consider the record.

II

The Jackson-Vanik Amendment to the 1974 Trade Act is the prototype of self-defeating policies. America's reverence for human rights led Congress to impose a link between free emigration from communist countries and the normalization of trade with them. Passed after protracted but unsuccessful bargaining between the late Senator Henry Jackson and Secretary of State Henry Kissinger, this measure effectively denied Moscow nondiscriminatory access to U.S. markets through the most-favored-nation status and access to credit facilities that a 1972 trade agreement pledged President Richard Nixon to seek. This law conditioned MFN, as well as government loans and guarantees for communist countries, on free emigration, subject to one-year waivers approved by Congress after the president reported a country's "assurances" of such emigration.

Jackson-Vanik was conceptually flawed, and it proved counterproductive in operation. By attempting to force Moscow to provide explicit public assurances regarding so sensitive a subject, the law failed on several counts.

It gutted the quiet diplomacy that had begun to yield significant increases in Jewish emigration. Under the Nixon Administration the number of emigres leaped from barely 200 in 1968 to almost 35,000 in 1973. After passage of the Jackson-Vanik Amendment, the exodus fell sharply to 13,000 in 1975; emigration rebounded only as relations warmed during the SALT II negotiations, reaching 51,000 in 1979. After the Soviet invasion of Afghanistan in 1979 and the frictions of the first Reagan term, the number of Jewish emigrants plummeted to less than 900 in 1984. The conjunction of Gorbachev's accession to power as General Secretary and the overtures of Secretary of State George Shultz revived a more favorable trend. Obviously, the flow of Soviet exit visas depended on larger factors than one heavy-handed section of American trade legislation.

The Jackson-Vanik Amendment proved costly in economic terms when Moscow repudiated the 1972 trade agreement in response to what the Soviet Union perceived as an intrusion in its domestic affairs. While the trade potential of that accord is arguable, its demise meant an end to the Lend-Lease settlement laboriously negotiated as part of the package. The settlement called for the Soviet Union to pay back over $720 million in World War II loans from the United States, a substantially larger fraction of the assistance it received than Britain had repaid for similar aid. Moscow paid initial installments on that debt, but it suspended payments in retaliation for Jackson-Vanik. (The balance due remains $674 million.) At the same time an agreement between the Soviet government and the Export-Import Bank on credits, interest rates and repayment schedules also died aborning.

In addition, Jackson-Vanik caught all communist states in its web. It retarded the development of U.S. economic relations with East European nations, ironically ensuring their continued dependence on the Soviet Union. Even when MFN status was granted to Hungary and Romania, trade was impeded by the uncertainties associated with annual waivers under Jackson-Vanik and the congressional debates required by the law. Romania, the one nation where the law may have favorably influenced emigration policy, finally renounced its trade agreement with the United States, forsaking commerce to be rid of Jackson-Vanik's waiver procedures. Thus the law did not promote either the economic or security interests of the United States or increase free emigration from the Soviet Union.

The Jackson-Vanik formula was shortsighted, but it is not the only such example. The outrage that Americans felt at the Soviet intervention in Afghanistan, and the urge to punish the aggressor, prompted President Jimmy Carter to impose the famous embargo on grain sales to Moscow. The exercise told more about the vulner-

ability of U.S. foreign policy to domestic expediency than it did about U.S. capacity to pressure Moscow by withholding grain. This grain embargo became a central issue in the 1980 presidential campaign, and within weeks after his election Ronald Reagan lifted the ban. By 1983 the United States had entered a long-term grain agreement with the Soviet Union in which the Soviets agreed to certain minimum purchases every year. President Reagan pledged not to impose such an embargo in the future. By 1988 he was offering to subsidize grain sales to the Soviet Union.

The grain embargo highlighted Moscow's leverage as a market for American grain exports. U.S. farmers' dominance in that market diminished because Moscow turned to other suppliers, notably Canada and Argentina. Now that the Soviets have diversified their sources, there should be no illusion about future U.S. potential to exploit Soviet dependence on grain imports.[1]

The confused U.S. attempt to impede construction of the major gas pipeline between the Soviet Union and Western Europe in the early 1980's was no more successful. Weighty considerations were raised. Would the deal lead to excessive European dependence on the Soviet Union for indispensable energy supplies? Would the hard currency earned by Moscow feed its military machine? Were components supplied by the Europeans likely to convey advanced technologies to the Soviets that the West would be safer withholding? Posing these questions, however, should not have triggered Washington's rush to judgment and extraterritorial actions that provoked the 1982 crisis between America and its allies. Perhaps the best to be said is the affair enabled Shultz to begin his tenure at the State Department with a notable achievement by repairing damage the United States had done to relations with its allies.

The Western alliance has long struggled to prevent commerce from fortifying an adversary. Repeated attempts to segregate strategic from nonstrategic goods, to control reexports, to differentiate between communist and free world exports, to ascertain foreign availability of comparable items, to resolve jurisdictional disputes and a host of other such problems have shown how difficult it is to regulate exports with military potential, especially when many products have dual purposes. Much attention has been drawn to periodic violations of the export control procedures agreed upon by members of the Consultative Group and Coordinating Committee for Multilateral Export Controls (CoCoM), which includes Japan and all the NATO countries except Iceland. One prominent episode involved the transfer to the Soviet Union of critical technologies manufactured by subsidiaries of Japan's Toshiba and Norway's Kongsberg Corporations.

The responsible governments addressed those violations as criminal offenses. Nevertheless, both firms became the targets of legislated sanctions in the United States. Such sensational transgressions have grave security implications, but they also obscure the general debilitation that an overloaded export control regime imposes on U.S. firms' trade in nonstrategic goods. According to the Department of Commerce in 1987 national security controls affected one-third of all U.S. exports of manufactures (other than military equipment). The slow motion review of export license applications conveys the impression at times that Washington is more interested in emulating Moscow's notorious bureaucracy than in rectifying its chronic merchandise trade deficit.

For much of the Reagan Administration, export control policy was snarled in a struggle between the Departments of Defense, Commerce and State, and between the House of Representatives and the Senate. The experience was not edifying, either for native observers or for the allies we purport to lead. Many felt that the result was again to wash U.S. firms out of competition for international sales that other suppliers were ready and willing to make. The Reagan Administration finally took advantage of a deadlocked Congress to formulate a policy that still subjects U.S. export licenses to long delays occasioned by Department of Defense review.

III

These episodes illustrate the incoherence of U.S. policy. Sour experience makes a powerful case for change. That change should begin with repeal of the Jackson-Vanik Amendment. It has not only poisoned the atmosphere for economic relations with the Soviet Union and other communist countries but it has blocked a reasoned

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[1] John P. Hardt and Kate S. Tomlinson. An Assessment of the Afghanistan Sanctions: Implications for Trade and Diplomacy in the 1980's. Report for the House Subcommittee on Europe and the Middle East, 97th Congress, 1st Session, April 1981. This Congressional Research Service report was requested by Chairman Lee Hamilton (D-Ind.). See also Abraham S. Becker, Economic Leverage on the Soviet Union in the 1980's. The RAND Corporation, July 1984, R-3127-USDP, pp. 30-44.

debate about those relations. Despite the fledgling progress in Soviet-American relations during the late 1980's, Jackson-Vanik still hovers like a predator, devouring economic possibilities before they can emerge from the nest.

The reasons for abandoning so flawed an endeavor are manifold. Apart from the failure to achieve the nominal purpose of unfettered Jewish emigration, the United States and its allies have now crafted more appropriate approaches to advance human rights. Frank and direct discussions with Moscow have resulted in some family reunifications and release of dissidents. Bilateral diplomacy of candor and detail has shown that it can address such matters fruitfully in the Gorbachev era. More important, the process created by the Conference on Security and Cooperation in Europe (CSCE) has reached a new plateau in agreements concluded at Vienna. These accords extend the commitment of all East European countries (except Romania) to freedom of movement and freedom of religion, including the right to provide religious instruction to children. And on these issues the Gorbachev regime has set benchmarks for itself which, other states will be able to monitor.

Secretary of State James Baker has stated clearly that Soviet compliance with CSCE standards will determine whether the United States follows through on the Reagan administration's pledge to attend the human rights conference planned for Moscow in 1991. It is through multilateral undertakings of this type, not misguided unilateralism, that we can best display our dedication to human rights. Nothing is more hopeful in the present era than the willingness of the Soviet leadership to expose its practices to wider international observation, whether in the verification of arms treaties or in the field of human rights. Perhaps here, too, Gorbachev sees that greater exposure to world opinion can make the Soviet fear of obloquy an ally in his striving for domestic reform.

Hopes for effective international action did not appear so promising in 1974, when the Jackson-Vanik provision was adopted. It has taken many years and disappointments to reach the current, more productive stage. Now that we have reached this point the various rationales for Jakson-Vanik have dissolved. What remains is the evident hypocrisy of applying the law in ways that are blatantly discriminatory and self-destructive of U.S. interests. It has never been applied as a sanction to force the free emigration of nonjewish populations anywhere; waivers of the law for China have been routine since Washington and Beijing normalized relations in 1979. Nor was there ever an interest in China's emigration practices, especially after Deng Xiaoping reportedly asked President Carter "How many millions do you want?"

In fact, it is not unknown for our government to urge others—Vietnam, for example—to stem the flow of emigrants. Even advocates of the Jackson-Vanik provision might feel a twinge of embarrassment that the U.S. embassy in Moscow has had to slow the processing of visas for refugees because of inadequate funds to resettle them. U.S. immigration law is highly restrictive, assigning quotas by nations and giving preference to skilled professionals over less fortunate candidates seeking entry.

The issue of Jewish emigration from the Soviet Union has taken on new aspects lately. There is progress toward renewed diplomatic relations between Israel and the Soviets, although the timing is unpredictable. Israel's embassy in Moscow is being refurbished. El-Al and Aeroflot are preparing new flight schedules, and joint ventures are under discussion between the two sides. Meanwhile, friction has arisen between Washington and Tel Aviv, as Israel presses the United States to help ensure that Jews emigrating from the Soviet Union go directly to Israel. But America cannot consistently uphold the right of free emigration while insisting that Israel be the sole destination for Jews.

Obviously, Jackson-Vanik is not to blame for all the complications in U.S. trade relations with communist nations. Furthermore, there are occasions when an expression of moral indignation is forth the economic price. But our policy toward trade with communist countries is a strange concoction of political opportunism and paralysis. It embodies a prejudice against doing business with communist states that is shared by few other nations. It produces no perceptible gains, and the economic and human costs are high.

In the end it is the politics of the Jackson-Vanik Amendment that constitute its central defect. Tying MFN and access to U.S. export credit facilities to another nation's emigration rules never made sense. Such selective linkage implies that if Moscow releases enough Jews, its actions in the Middle East, Afghanistan, Central America or elsewhere are relatively unimportant—at least so far as trade is concerned. Whatever the utility of such a posture in American politics, it is an untenable stance in international politics.

Many factors impinge on U.S. relations with each of the communist countries. Congress and the president need to weigh them all in order to reach a rounded judg-

ment of the national interest. The singular preoccupation of the Jackson-Vanik standard prevents them from doing so. Repealing it would help to clear away the incoherencies obstructing trade and finance. It would enable the United States to shape a fresh assessment of East-West relations and to pursue its security interests with useful political flexibility. It would signal American recognition of meaningful change in the Soviet Union's behavior, both, within and outside its boundaries. It would also comport with the nascent pluralism among communist nations flow treated as a Soviet bloc.

Others will press for the use of the president's authority to grant waivers under Jackson-Vanik instead of its repeal. Exercising the waiver authority would place the Soviets on the same footing as the Chinese, and would let the leash out a bit without abandoning the legislation per se. Members of Congress might find it politically easier to support a waiver, rather than outright repeal.

In making case against the waiver option we consider several points compelling:

—Waivers focus exclusively on Jewish emigration, neglecting other aspects of Soviet behavior important to the United States.

—The Jackson-Vanik Amendment only applies to communist countries, suggesting that the emigration policies of non-communist countries do not matter.

—Annual waivers deny businesses the multiyear-planning frames needed for trade and investment decisions, threatening orderly economic relations.

—This Soviet Union might again refuse to capitulate and offer the "assurances" demanded to gain a waiver; holding to the waiver option might be tantamount to rejecting MFN and to barring normal commerce. After all, Andrei Gromyko emphasized to Kissinger before the amendment passed that the Soviet Union would not accept a trade relationship based on Jackson-Vanik.

In short, a waiver would do little for trade—and its invidious character may do more to inflame the Soviets than to encourage them.

The Union of Councils for Soviet Jews has called for the repeal of the so-called Stevenson Amendment, repeatedly enacted since 1974, which places a $300 million ceiling on new Export-Import Bank loans and guarantees for the Soviet Union (beyond the $469 million outstanding in 1974). As it happened, the blanket prohibitions of the Jackson-Vanik Amendment render that provision moot. Repealing the Stevenson Amendment would be meaningful only in conjunction with lifting the Jackson-Vanik constraints. Neither provision is appropriate to today's circumstances.

Repealing Jackson-Vanik would not resolve the specific issues that a coherent policy must address. Negotiations would be necessary to determine on a country-by-country basis whether, when and under what conditions to grant MFN status. The abandoned 1972 trade agreement and the concomitant Lend- Lease settlement would have to be renegotiated. There would surely be no presumption of automatic access to Export-Import Bank guarantees or credits. Statutory restraints on loans by private U.S. lenders, i.e., the 1934 Johnson Debt Default Act, would remain applicable until the Soviet Union and the United States reacted satisfactory settlements on long-standing disputes over "sovereign debt." Though evaded by U.S. banks with foreign branches, this act is another candidate for review—one more example of how U.S. policy restricts American companies to the benefit of foreign competitors but with little effect on the targeted country.

Once the legislative barriers are eased, most of these issues may be properly handled in executive branch channels and in multilateral venues. If commercial bank lending to the Soviet Union poses undue economic or political risks, then one sensible recourse would be cooperative reserve requirements or other measures worked out through the Bank for International Settlements (BIS).

IV

It would be shortsighted to swing abruptly from the rigidity of the Jackson-Vanik Amendment to an arrangement that excluded Congress from the process of continuing review of Soviet-American economic relations. Congress will continue to oversee trade agreements with communist countries, including the decision to grant MFN status. It will want to be assured that remedies against dumping and other unfair trade practices, unavailable under the General Agreement on Tariffs and Trade (GAff), are readily available from the International Trade Commission and other U.S. agencies.

However encouraged they may be by Soviet behavior under Gorbachev, legislators also share their constituents' wariness. They will insist upon a step-by-step approach. They share with the president the responsibility to gauge those steps, and they will not displace the Jackson-Vanik Amendment with a carte blanche for Soviet use of Export-Import Bank facilities. What is needed is a flexible procedure

that enables Congress to join with the executive in a periodic evaluation of the relationship, taking account of the entire range of relevant factors.

With respect to Export-Import Bank assistance, Congress could establish a separate authorization procedure for loans and guarantees to communist countries. These authorizations would be reviewed in the normal course of Export-Import Bank legislation. This proceedings would provide an occasion for wide-ranging legislative appraisals of overall relations with communist countries. In this manner the United States could establish implicit linkage to the full range of relevant behavior, rather than the explicit linkage to a single factor that the Jackson-Vanik Amendment requires.

This financial setting for Soviet participation in Export-Import Bank programs is today quite different from that of the early 1970's. In 1973–74 Export-Import Bank credits to the Soviet Union surged from zero to over $450 million before screeching to a halt. This Organization for Economic Cooperation and Development (OECD) now classifies the Soviet Union as a "Category I" borrower, for which no subsidies are permissible. Except for Israel, the Export-Import Bank tends not to lend directly to Category I countries, and officials doubt that the Soviets would find the bank's loans competitive with those available elsewhere.

While the bank is strapped for funds to offer credits, its authority for loan guarantees is more ample and relevant to the Soviet case. For U.S. banks, the Export-Import Bank guarantee programs could be useful if spreading the risk and in easing the limits on loans to a single sovereign debtor. Although reluctant to pay the bank's fees, Moscow might wish to exercise a right to guarantees as a demonstration that the taboo on doing business with the Soviet Union no longer prevails. Thus, as a practical matter, the issue today concerns guarantees of loans by other lenders, not the direct loans that increased so noticeably in 1972–74.

The Reagan administration began a gradual movement toward more normal economic relations with the Soviet Union. Led by the late secretary of commerce, Malcolm Baldrige, the U.S.-Soviet Joint Commercial Commission in 1985 resumed sessions that had been suspended indefinitely in 1978. Various trade promotion activities have ensued, with hundreds of American businessmen visiting Moscow. Reagan lifted a ban on sales of some oil and gas equipment to the Soviets, a sanction tightened at the time of the Afghanistan invasion. He also allowed imports of Soviet nickel and furs to resume. Before leaving office Secretary Shultz recommended that COCOM end the "no exception" ban on high-technology exports after the Soviets withdrew from Afghanistan. The European allies support this return to a case-by-case review of such sales. U.S. reticence on this point could revive European fears of more "light switch" diplomacy-and Soviet suspicions that concessions only invite demands for more concessions. The ban should be lifted.

Increased commerce with the Soviet Union has been slow, but some developments are potentially significant. Several major firms have formed an American Trade Consortium and negotiated arrangements to permit repatriation of profits from operations in the Soviet Union, perhaps a model arrangement that will permit more income and capital flows to and from joint ventures there. In December 1988 the Soviets further adjusted their rules for joint ventures to permit foreign participants to hold equity majorities and to delay taxation until several years after initial profits are realized. They also increased the number of Soviet organizations authorized to deal directly with foreign partners and suppliers. These attempts to accelerate the pace of the Soviet economies engagement with foreign investors and markets reveal an alertness to the weaknesses of Moscow's first steps in this direction. American firms were involved in only about 15 of some 200 joint ventures.

These Soviet reforms follow similar measures in China and Hungary. Perhaps the largest economic opportunities for the near future are in Eastern Europe, where capitalist, free market traditions are rooted. Natural trading partners are divided by artificial political demarcations, and the human and economic infrastructures run deeper than in the Soviet Union and China. These different economic potentials, reflecting the various political and economic contexts of the several countries, invite an East-West trade policy that itself is capable of differentiating. The present U.S. policy takes too little account of the liberalizing tendencies within communist countries and of the decentralizing tendencies within the communist "bloc."

This policy flaw bears on export controls. The United States pays a high price for the quaint notion that trade is a privilege. By some estimates export controls have cost U.S. firms between $7 billion and $9 billion in exports and 180,000 jobs annually. A National Academy of Sciences survey of almost 200 firms found that over half claimed to have lost sales because of these controls. Such controls also hurt U.S. sales with non-communist countries; 26 percent of the companies surveyed said they had lost deals with free world customers because of export controls, and over a third

of the companies reported such customers preferred to shift to other suppliers outside the United States. In 1985 the control process handled proposals approaching $80 billion in value. This gives an idea of how far it ranges beyond direct trade with the Soviets.[2]

In a wide-ranging review of COCOM's record, the National Academy of Sciences studies have urged a new balance between national security export controls and commercial considerations. They called into question the feasibility of enforcing the extensive COCOM list of controlled items and pressed for stronger enforcement of more limited restraints—"higher fences around fewer items." These studies and consultations within COCOM have helped build a consensus to shrink the export control list. In addition, the verdict emerged that, however compressed the list, the executive branch had to pick up its own tempo to reach timely decisions on export applications. With that goal in mind, the 100th Congress trimmed the Department of Defense's authority to delay the process, limiting DOD export license evaluations to "national security" as distinct from "foreign policy" considerations. It remains questionable whether such exhortations will be more effective than those in the past.

In the end, there must be some recognition that technology is inherently difficult to control. It travels on paper and in the human mind, as well as in tangible products. It is usually available from many sources. Security requires control of exports with clear military applications to adversaries. But the West's technological supremacy depends upon its economic and intellectual environment, resources for the development of inventions and their rapid application to commercial and military uses. The United States must stay ahead through a nurtured process of basic research and technological innovation.

V

It is essential to state the issues confronting U.S. policy with some precision. Posing the question "Should we help Gorbachev?" tends to divert discussion into narrow byways. If all the change that is transpiring in the Soviet Union rests on a single individual, if it has no roots beyond Gorbachev's alluring rhetoric, then there is little ground for optimism about its durability-or his. If the innovations are tentative and perishable, one would not be wise to argue for shifting American policy onto sandy terrain.

This dawning consensus, however, is that the changes within the Soviet Union are erupting from sources too deep to permit their suppression even if Gorbachev's tenure turns out to be relatively brief. He is a creature of economic and strategic necessities already recognized in China and other communist countries. What is remarkable is that this historical inevitability has been so slow in coming—and that it has not yet appeared in many communist countries. Fidel Castro and Nicholae Ceausescu are defiant.

Some reform initiatives may prove abortive, but the United States can shape policy on the probability that the broad tides of change will continue to flow. That expectation rests not on naivete, but on the calculation that attempts to revert to Stalinism would guarantee economic failure and political decline—and that even the old guards in Moscow and Prague can perceive these hazards. It rests on some conviction that what we have been saying about the superiority of our self-governing, capitalist systems in the West is inescapably true.

For policy purposes, it is not necessary to predict an outcome with certainty in order to prefer it. Surely, from the Western standpoint, a Soviet system that must become more benign in order to become more powerful is preferable to one that joins excessive military capability with the malign impulses of totalitarianism in decline.

But to welcome perestroika is not to advocate paying for it. In truth, there is little likelihood of excessive American investment in the still risky Soviet economy. The U.S. business community has long since discounted forecasts of easy or early profits in the Soviet market. There is impatience with the sluggish bargaining required to close deals with Soviet bureaucrats and enterprises. Permitting U.S. investment in the Soviet economy is not payment for perestroika. It merely means repealing provisions that hamper commerce and penalize American companies.

As far as Soviet exports to the United States are concerned, the range of candidates remains limited. Over 90 percent of Soviet hard currency exports consist of oil, gas, gold, and arms, not manufactures that would displace major domestic

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[2] Carol Rae Hansen, U.S.-Soviet Trade Policy, Washington, DC: The Johns Hopkins Foreign Policy Institute, 1988, pp. 10-11.

sales by U.S. firms. It is conceivable that buried deep in Soviet archives and laboratories are ingenious developments waiting to be commercialized, but so far the examples are few, e.g., sales of electromagnetic casting technology and an ion-gun hardening system for industrial cutting tools.

Understandably Moscow hopes that the joint ventures it now encourages will concentrate on exports to generate hard currency revenues, but the projected scale of such enterprises remains relatively modest. This volume of trade with communist countries may be small, but these are nations with which the United States can run a needed trade surplus.

The apprehension that the United States might be lured into paying for perestroika seems to focus on official credit arrangements, perhaps reflecting concern about methods once employed to pursue detente. If Moscow were to become eligible for Export-Import Bank financing, as agreed in 1972, today it would face stiff competition for the bank's limited resources. There is no disposition in either Congress or the executive branch to allow Export-Import Bank guarantees to become a surrogate for foreign aid, for example, underwriting development in Soviet Siberia. In the midst of U.S. budget stringencies and chronic trade imbalances the bank is obliged more than ever to husband its authority and to devote its efforts to improving American export performance.

We do not suggest lending money to finance perestroika or denying credits to achieve some political purpose. It is unlikely that Soviet policies will be influenced materially by proffering or withholding cash. This clearest justification for official export assistance is the competitive imperative. If assistance is necessary to put U.S. exporters on an equal footing, then the Export-Import Bank should be in position to help. If there is foreign competition that requires official financial participation in U.S. ventures, the solution is not to punish American exporters but to negotiate international terms that prohibit subsidies. Such negotiations are best pursued with leverage, not with a unilaterally disarmed Export-Import Bank.

To preclude Export-Import Bank participation in business with communist countries discourages exporters, investors and private lenders from exploring opportunities. In any case, the bank's primary function is not to do the whole job but to lubricate the larger process. To the extent that there develops a need for selective use of Export-Import Bank assistance in trade, the option should be open. Otherwise American traders and financiers carry a handicap that their counterparts in other Western countries do not.

VI

There appears to be a good understanding at the highest levels in Moscow that one way to energize Soviet domestic enterprises is to subject them, albeit gradually, to the stresses of international competition.

The emphasis on opening the Soviet Union to foreign investment and on working toward convertibility of the ruble reflects this insight. More than nostalgia lies in the recollection that Lenin had a convertible currency. This opening is a farsighted appeal for a return to pragmatism, coupled with a straightforward acknowledgment that the transition from the current 6,000 variations ("currency coefficients") to a unitary ruble exchange rate will take a decade or more.

For the West the prospect of convertible currencies and an end to the Council for Mutual Economic Assistance poses interesting policy questions. Few measures would contribute more to the predictability of transactions with communist countries than the shift to currencies readily traded on world markets. Such a development could testify to the growing strength and independence of communist economies. It could help to stabilize East-West economic relations.

Yet Soviet reformers who foresee a "fully" convertible ruble by the end of the century are optimistic. The painful changes entailed in moving to convertibility are meeting both bureaucratic and grass-roots resistance. Retail price reforms are already behind schedule and worries about inflation are mounting. Western imports needed for restructuring will be costly while Soviet export potential (barring an oil price increase) appears rather low. Without a surge in hard currency earnings, Moscow's borrowing capacity will be limited, perhaps to another $20 billion or so. This calculus puts full convertibility of the ruble far into the future, although there may be intermediate stages centered on special economic zones, hard currency auctions and partial convertibility.

But do we want communist economies to be integrated into the world capital and trading system? Certainly not the Soviet economy we have learned to distrust. The economy Gorbachev envisages, however, would be a different matter. A Soviet economy that had undergone the transformations now contemplated could become a con-

structive participant in the international economic system arduously constructed by the free market countries.

With commitments to change being advertised by Moscow and other communist regimes, the United States and its allies cannot avoid a considered judgment about how to respond to these innovations as they unfold. The speed of reform will vary from one country to another, but the direction seems clear. Hungary is leaning West, and Czechoslovakia and East Germany could restructure sooner than the Soviet Union, if they were so disposed. The prudent case-by-case engagement of these nations with the Western economy is a looming opportunity. It poses a particular challenge for the European Economic Community. It might as well involve a reformed Hungary as a remote Turkey.

The rejection of a Soviet request for observer status at the 1986 GATT meetings in Punta del Este conveyed reasonable doubts about whether a state run economy could mesh with the market-oriented universe to which that organization is dedicated. But a number of American analysts incline more positively toward some form of Soviet association with GATT, on the theory that it could provide a window on Soviet economic activity and enable outsiders to encourage genuine price reform and the decentralization of markets.

Looking ahead, there has been speculation regarding future Soviet involvement in the International Monetary Fund. Leaders in Moscow have pointed out that all IMF relationship could expedite the country's graduation to currency convertibility. They note that a place in IMF would not give a veto to the Soviet Union and that, given the IMF structure, Moscow would hardly have enough leverage to disrupt its functions. Hungary and Poland are already members and the prospect of an eventual Soviet connection to IMF warrants examination.

As we evaluate these issues, it is reasonable to argue that a Soviet Union more engaged in the global economy would be less prone to backsliding in its economic and political evolution. In the phrase of one close observer, Brezhnev wanted foreign investment to avoid reform, Gorbachev wants it to foster reform.

Another development demands consideration by U.S. policymakers. While the Soviet or communist "bloc" is fragmenting, other nations, bound by a commitment to capitalism and by geographical proximity, are forming economic blocs in Western Europe, the Persian Gulf and North America. Where will the colossi of the communist world fit in this emerging, regional shape of things? It is too glib to say that they do not fit. In a new age of regional cooperation the free countries of the Pacific will be dealing with two communist mammoths, Russia and China, both hungry for trade and capital.

Does the communist countries' pursuit of foreign investment threaten U.S. interests? One can imagine scenarios in which it might do so. Gullible Western investors, shown the green light by changes in public policy, might divert so many resources to Soviet projects and joint ventures that they deprive other needy nations of capital. That redirection of capital flows could drive up the cost of funds to everyone, including the United States Reverse leverage could come into play, with the American government and its allies under pressure to do nothing that might prompt the Soviets to default. These concerns are valid, but not conclusive. Western banks' painful over exposure in Latin America and Eastern Europe, especially Poland, has bred a healthy caution about concentrating too eggs in the Soviet basket. Most lenders have relearned the old banker's adage that "if a man owes you a hundred dollars, he's got a problem; if he owes you a million dollars, you've got a problem."

Present evidence makes worst-case anticipations implausible. The Soviets and Chinese historically have been prudent, cautious, even reluctant borrowers. Sovereign borrowers, no less than others, cannot afford to antagonize the biplayers in Western capital markets. Besides, the West always as its assets to sequester, as Iran discovered. The risks are not exorbitant.

An interagency study done late in the Reagan Administration found that rumors of massive Soviet borrowing in the mid-1980's were exaggerated. Dependable data are difficult to come by, but it appears that, adjusting for exchange rate shifts, total hard currency debt in the Soviet bloc grew by only about 14 percent from 1981-86, and in fact declined if measured in constant dollars. Net Soviet debt to lenders reporting to the Bank for International Settlements, i.e., gross debt minus deposits in BIS banks, was actually less in 1986 than at the start of the decade. The study concluded that the Soviet capacity to service its debt is quite adequate.

To be sure Moscow has begun to dabble with bond issues underwritten in the West, and during 1988 Western lenders extended lines of credit amounting to several billion dollars, most of which are thought to be tied to purchases of consumer goods and equipment. The U.S. government believes that the majority of these credits are officially guaranteed, export-related borrowings permissible under OECD

guidelines. This contrasts with the pattern of Soviet loans earlier in the 1980's, which appeared to be generally untied. Two-way trade with nonsocialist countries slackened somewhat, but Wharton Associates projects volume reaching $95 billion in the early 1990's. In the estimate of Soviet economist Abel Aganbegyan, removal of trade barriers could bring bilateral U.S.-Soviet trade levels up to a range of $10 billion to $20 billion within five to seven years.

Some analysts foresee Soviet hard currency debt rising from less than $30 billion in 1985 to over $50 billion in the near future.[3] The Soviets themselves are quite chary about this trend, and Gorbachev's advisers seem determined to hold debt service below 25 percent of export earnings. They look instead to joint ventures to attract perhaps $20 billion in the near future, noting that China already has foreign investment commitments of that magnitude.

All things considered, alarm over Soviet penetration of Western capital markets is premature. From a policy standpoint the important objective in the near term is to improve the means of monitoring Moscow's activities in those markets. That task is part of the more general need to develop adequate information about capital flows—now so rapid and dominant an element in the global economy—as a building block for intelligent policy and for government interventions, when necessary to maintain stability. The United States will have more clout in extracting that information from the Soviets if it is a player, rather than a bystander, in Gorbachev's enterprise.

The shift in policy emphasis recommended here does not prejudge whether American firms will discover enticing and large-scale opportunities in the Soviet Union. Our contention is simply that the government should not strangle their search for such opportunities by policies that preempt consideration of mutually acceptable economic possibilities. The message is: let businessmen strike bargains they deem profitable—and keep enough steerage over U.S. policy to hold a safe and steady course in our overall relationship with communist states.

It is often the essence of political decisionmaking that governments must choose before there is a confident basis for judgment. So it is in shaping the next phase of U.S. economic relations with communist countries. The mistakes of the past 15 years are clearer than the path into the next century. But, while remaining alert to the dangers, American policy should lift the impediments barring its citizens from exploring that path actively. In today's world economy, inertia is a recipe for neither prosperity nor security. There is no standing still.

Prepared Statement of John P. Hardt and Timothy W. Stanley

INDICATORS OF CHANGE IN SOVIET SECURITY POLICIES

HIGHLIGHTS

Unprecedented developments in the Soviet Union may have opened the door to a long sought movement toward conventional force stability in Europe that would lower the military equilibrium substantially, cut economic costs, and diminish the risks of an accidental conflict. In particular, the unilateral force reductions announced by Mikhail Gorbachev, and his proposals to make asymmetrical cuts and undertake internal military restructuring, confront NATO at once with startling opportunities and sobering challenges.

One of those challenges is to manage the adjustments that will be demanded in NATO in any case, to squeeze an adequate defense into constrained national budgets and cope with classic burdensharing issues, while at the same time negotiating with the East and preserving Western public support. The opportunity is to develop a new conventional balance in Europe under carefully negotiated conditions, perhaps as much as fifty percent below present NATO force levels, in the judgment of one senior expert, so that neither side would have to fear an attack by the other. But an effective system of verification and inspection must be installed to provide the confidence necessary to make such reductions possible. In this remarkable period of policy evolution in the USSR it seems essential for the West to establish reliable indicators of substantive change in that country, for the guidance of NATO's defense planning and arms control efforts and the conduct of East-West negotiations.

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[3] See Report of the Special Interagency Task Force on Western Lending to the Soviet Bloc, Vietnam, Libya, Cuba, and Nicaragua, 1988; also Hansen, op. cit., p. 32.

The paper looks for hard evidence, measurements and trends in Soviet security policies that may be either positive or harmful to the prospects for improving East-West relations. The authors judge the following categories, which are interrelated but not necessarily "linked," to the particularly relevant.

Nuclear Forces

Whether we are moving toward, or slipping away from the goal of stability in offensive and defensive strategic weapons would be the key finding. Trends should show up in how verification regimes are faring, for example, or whether START is being held hostage to long-range strategic defense issues.

On short-range systems, a Soviet move to exploit NATO's nuclear modernization dilemmas or seek to decouple U.S. capabilities from NATO's flexible response strategy, would obviously be a negative indicator. Continuing Soviet restraint in seeking "compensation" for British and French nuclear forces, however, could be seen as positive. Of course, any violation of the INF accords would place a roadblock in the way of further arms control.

Conventional Forces

A review of the major missions of the Soviet armed forces suggests that, in the context of perestroika and new foreign policy thinking, there is room for substantial further reductions of a million or more men beyond the unilateral steps Mr. Gorbachev announced on December 7, 1988.

In the ground forces category, most of the suggested indicators are keyed to the concept of "defensive" deployment: overall manpower deployed * * * units deployed in forward zones from the Atlantic to the Urals * * * ratios of offensive weapons such as tanks, to defensive ones, and the overall numbers deployed * * * assault (river-crossing) systems deployed forward * * * how field armies are structured, in terms of operational maneuver groups and airborne and special forces units * * * changes in readiness status and shifts toward Categories B and C in manning levels * * * maneuver and training doctrine and confidence-building measures.

Since the Soviets believe NATO to be superior in strike aircraft, the paper suggests that Western concessions may be needed in negotiations to limit airpower, as a tradeoff for the exclusion of naval forces. But unilateral Soviet cutbacks in naval deployments and exercises outside of home waters and in naval construction would be positive indicators.

Resources for Defense

The authors argue that the kinds of changes that affect the future capabilities of Soviet military are more important to Western confidence in conventional arms control regimes than are shifts in doctrine or deployment that can be reversed more easily.

They note the unprecedented debate in the Soviet Union over the burden of defense on the economy. Civilian officials and well placed academics argue for deep military cuts in order to transfer personnel, materials, plant and research to restructuring and modernizing the civilian economy and alleviating shortages of consumer goods. While the Soviet military have also supported perestroika in principle, they have only reluctantly accepted such defense changes as unilateral withdrawals and asymmetrical cuts.

As the leadership copes with the resulting "trilemma" of guns versus butter versus growth, valuable indicators of change include military manpower and officer strength * * * conscription numbers and terms of service * * * construction capabilities * * * defense production capacity and output * * * military R&D * * * tradeoffs between military and civilian technologies * * * and military benefits from foreign commerce. "Leading" indicators which predict future shifts from defense to civilian capacity are especially important.

The authors believe that Soviet supporters of perestroika have a real self-interest in glasnost on military-economic affairs and particularly in exchanges of data with the West that could reduce the need for intrusive conventional arms-control verification and which could also help illuminate their internal "trade-off" debates. The West should therefore pursue such exchanges through official and other channels and follow up Mr. Gorbachev's offer to discuss plans for the "conversion" of military to civilian capacity and to share data on defense spending.

International Security

Here, indicators in the "new model" Mr. Gorbachev outlined at the UN are examined: as they bear on the acceptance of a permanent U.S. role in Europe; as to whether post-Afghanistan Soviet behavior is cooperative or disruptive toward re-

gional or Third World conflicts; and as to the extent of Soviet support for UN peacekeeping roles.

Other indicators of change may be found in Soviet behavior toward the nonproliferation of nuclear and chemical weapons, transfers of arms to unstable areas, other arms control positions, and cooperation against terrorism.

As market economies continue to outperform socialist systems, Soviet gestures toward integration with a world market economy are positive and reassuring, through not yet very advanced. The same is generally true of political liberalization at home and with respect to Eastern Europe, although the widespread successes of reform candidates in the contested Soviet legislative elections are historic. Regression in such categories might bode ill for the future economic reform and military restructuring.

CONCLUSIONS

The main task for NATO is to respond to the Soviet opening without cutting too much too soon. The paper advocates a dual-track Western policy of cautious optimism and healthy skepticism, aimed at keeping NATO's powder dry and maintaining the cohesion of the Alliance as we develop glasnost in data exchanges, encourage market-oriented perestroika, and do what we can to stimulate Soviet military reform.

The authors believe that to be as forthcoming as the opportunity demands, the West must simultaneously negotiate toward the ambitious goal of large-scale mutual force reduction based on parity, even as the Alliance wrestles with its own economic limitations and the political dynamism of its constituent democracies. As we work within the lowered perception of threat from the East, we must never lose sight of the serious asymmetries in the mobilization and reinforcement capabilities of the two sides, or of the risks a hard-line succession to Gorbachev could pose.

The authors have sought to show by realistic examples that the economic and military indicators are available and can be disclosed so that we may go beyond "trust" to verify what is really going on, with full regard for the political "atmospherics." Therefore, identifying and monitoring the critical indicators of change in Soviet policies, along with traditional negotiation techniques and the bilateral exchange of data should be high on NATO's agenda as it celebrates four decades of keeping the peace.

STATEMENT OF THE ASPEN INSTITUTE—REPORT AND RECOMMENDATIONS OF A POLICY SEMINAR, AUGUST 25–27, 1988

ECONOMIC DYNAMISM AND EXPORT CONTROLS

I. BACKGROUND

Over the last eight years, the policies and management of controls on the export of sensitive dual-use technologies and products have been a bitterly debated and contentious issue. In response to this debate, a National Academy of Sciences panel proposed in 1987 that U.S. policy in this arena should promote the economic vitality of Free World countries and invigorate the domestic technological base, in addition to the traditional task of impeding the flow of sensitive technology to the Warsaw Pact. What the NAS panel was calling for was a broader definition of national security.

Export Controls

Since the NAS study, there has been substantial progress in the administration of the export control program. Turn around time for issuing most licenses has improved. Export licenses have been given a much higher profile with the creation of an Under Secretary position within the Commerce Department. The number of unilateral controls on U.S. goods has been reduced, computers play a much larger role in moving a case through the system, regulations controlling U.S. parts and components have been liberalized, and dispute resolution is working more smoothly.

Even with these important reforms the policy "gridlock" on this issue remains and is so tough to resolve that the NAS recommendations have led only to modest reforms. Congress has responded with some reform provisions of their own in the Trade Act of 1988, but these provisions will not ensure that reform measures are carried into action. Acceptance and a sense of urgency within the executive branch of the need for reform is essential if new measures are to be carried out successfully. Emerging trends in international markets point to one conclusion: The U.S. must adapt its export control program to new realities if we are to maintain leadership in

the development and application of new technologies, especially information technologies.

II. FACING UP TO THE REAL WORLD

Three major trends, all with profound implications for the U.S. industrial base and our national security, are now evident. These trends are the changing information environment and the speed at which new knowledge is absorbed around the world, continuing Soviet sluggishness in absorbing the emerging information technologies and therefore new knowledge, and the growing importance of international trade, especially high technology trade, to the health of the U.S. economy.

(a) *Importance of Access to Knowledge.*—The centerpiece of our national strength, military and civilian, is our capacity to produce, acquire, and disseminate knowledge, especially new knowledge. As a result, to deny access to markets for information technology is to deny access to knowledge. Such denial shrinks the raw material for innovation, which is new knowledge. It neglects the strategic value of being first in emerging markets. And it reduces the income stream available to U.S. high technology industry to support a strong U.S. research and development effort to produce new knowledge.

(b) *Soviet Failure to Absorb New Technologies.*—It is too early to determine whether Perestroika and Glasnost will result in far-reaching reforms. It is clear, however, that Soviet central planning has been the main reason for the USSR's inability to take advantage of the information revolution across the board. In some respects, the Soviet system has itself been an effective instrument in averting the loss of Western technology to the USSR. It remains true, however, that the Soviet Union has been quite effective in absorbing Western technology for military purposes.

(c) *International Economic Environment.*—The United States can no longer be cavalier about addressing competitiveness concerns in the world market especially for two reasons:

1. International trade is critical to the future health of the U.S. economy. International trade as a percentage of U.S. GNP has grown dramatically from less than 10 percent in the 1960's to the point where it may soon account for 25 percent.

2. U.S. is generally much more competitive in the high end of technology trade, which is where security export controls are concentrated. As a result, a poorly managed export control program can impose higher economic risks for the U.S. than for our main competitors, who are also our military allies.

(d) *Japan.*—To a large extent, initiatives on export controls are only part of a larger concern that the United States faces a critical juncture in addressing international competitiveness. Of special concern is that Japan is successfully pursuing long-term "take-lead" strategies in a wide range of high technology arenas. Targets include high definition television, supercomputers, semiconductors, advanced robotics, and biotechnology, to name just a few. The participants agreed that American technological leadership is vital in many of these sectors for sustaining long-term growth and economic prosperity for the United States. The defense industrial base, so important to our national security, would also suffer if U.S. technological leadership continues to falter. However, the solution to this problem will not be easy. Fundamental problems remain for the U.S., including the low savings rate, declining education standards, and tax disincentives for R&D capital formation. All of these problems represent difficult public policy issues that will have to be addressed vigorously and soon.

III. THE ELEMENTS OF REFORM

(a) *Reduce Controls on West-West Trade?.*—One potential remedy for addressing this new environment is to accept greater risks in managing exports in West-West trade. However, we need first to understand the risks and rewards of largely removing West-West expert controls.

Taking more chances on West-West trade means there will be some risk of increased diversion from "Free World" countries to the Soviet Union and Eastern Europe. However, our analysis indicates that isolated diversions do not represent the same level of threat as direct and sustained sales relationships that involve continuous sharing of information technology. In addition, the U.S. gets an important strategic benefit as competitiveness is enhanced whenever U.S. enterprise can be first in a new market—including markets in the Free World beyond Japan and Western Europe.

(b) *Put CoCom on a Diet.*—The United States has said it is willing to cut the CoCoM multilateral control list to the truly strategic dual-use technologies if our

allies promise the strengthen their export control programs. Our allies have agreed to enforce controls (on their own exports, and the reexport of our exports to them) on the items that would then still be on the list. So we now have an agreement "in principle."

Carrying this "in principle" agreement into action is both an important and an urgent assignment for the new Administration. It will not be good enough to have another round of tactical list cutting by staff experts from several contending agencies, unless U.S. strategy is clear. The U.S. faces a serious risk of loss of credibility, and perhaps the future effectiveness of CoCoM , if we fail to demonstrate follow-through on streamlining the list of strategic goods. What is needed is a strong signal from the new U.S. President and his top appointees in the Departments of State, Defense and Commerce.

(c) *"Wise Men".*—The issues discussed in this report will provoke some very difficult arguments among the United States and its various kinds of allies. If these are handled as issues for routine diplomacy or left to expert gladiators in the CoCoM process, they are likely to fester and become embarrassingly public disagreements among nations who will need to be working together across a very broad spectrum of security, monetary, trade and development policy issues.

We have two suggestions:

1. The need for allied solidarity on security export controls is so important that the policy questions, carefully formulated through advance negotiation, might well be on the agenda of the first Economic Summit held after the new President of the United States comes into office.

2. In the creative period of alliance-building a generation ago, both in the Marshall Plan and the North Atlantic Alliance, there was an extraordinarily useful process whereby the allies agreed to appoint very small groups of "Wise Men" (people such as Averell Harriman and Jean Monnet) to act for the allies as a group in recommending to governments a course of action which did not seem tractable through ordinary multilateral diplomacy.

Once the new Administration "has its own act together" it might well be useful to place in the hands of a very small group of wise people with international reputations (in our time, of course, no longer only "Men") the concerning of strategy on the issues discussed in this report in order to facilitate important reforms in the multilateral export control process.

Statement of The Heritage Foundation, Washington, DC

A yellow light on U.S. joint ventures with the Soviets

Introduction

When 500 American businessmen arrived in Moscow this April to talk about joint ventures with the Soviets, the message was clear: joint ventures with the USSR are back on the United States agenda. They also, of course, are on the Soviet agenda. Soviet General Secretary Mikhall Gorbachev perceives joint ventures to be potent medicine for reviving a deeply ailing Soviet economy. While such joint ventures are mainly commercial deals, Washington does have the responsibility to flash a yellow warning light to caution American businesses and the U.S. public of the pitfalls in doing business with the Soviets.

Gorbachev's efforts to create a more dynamic Soviet economy ran inlto trouble last year, when the Soviet gross national product grew by less than one percent.[1] As a way out of this economic slump, the Soviet leadership has pushed aggressively to establish joint ventures with Western firms. "Joint ventures," sometimes more precisely termed "operating joint ventures," are partnerships through which a Soviet enterprise and one or more foreign firms create a separate entity for economic activity. From a Soviet perspective, these enterprises are designed to upgrade Soviet production and efficiency, resulting in better goods for domestic consumption and higher quality exports to earn much needed hard currency.

Hard Currency or Rubles?.—As part of the new U.S.-Soviet rapprochement, this April 14, the two countries concluded a protocol to the June 1974, bilateral Long-Term Agreement to Facilitate Economic, Industrial, and Technical Cooperation. The protocol states that the Long-Term Agreement specifically includes joint ventures.

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[1] "Gorbachev's Economic Program: Problems Emerge," a Report by the Central Intelligence Agency and the Defense Intelligence Agency to the Subcommittee on National Security Economics of the Joint Economic Committee, April 13, 1988.

Activities under the protocol are to be monitored by a Joint U.S.-USSR Commercial Commission. The two countries are also establishing working groups to facilitate joint ventures in oil and gas equipment, construction equipment. medical equipment and supplies, textiles, and the food industry.

American businessmen interested in pursuing joint ventures must evaluate a number of factors about the commercial viability of joint ventures. Examples: How will the Western partner recover hard currency rather than rubles from products sold on the Soviet market? How will the rigid rule that there must be a Soviet majority on the company's board, under a Soviet chairman Soviet director general in charge of operations, affect business? How much should be paid for Soviet labor and raw materials? How will the Western partner ensure quality control?

U.S. businessmen also must consider the foreign policy and national security implications of joint ventures. Joint ventures, for example, could provide an advantage to the Soviet economy by introducing goods and services that can go on the market immediately. This would eliminate the painstaking and often flawed process of having to adapt Western technology. It could allow the Kremlin to ride out the immediate economic crisis without fundamentally reforming the economy or cutting the USSR's massive military budget.

Facilitating Soviet Espionage.—Pentagon officials worry, moreover, that the joint ventures could obtain technology and management know how easily adaptable to the military sector, particularly in computer-related areas. Extensive Soviet contacts with U.S. businessmen and technical experts beyond the initial stages of the venture also might lead to the inadvertent transfer to the Soviets of sensitive information and facilitate Soviet espionage.

To prevent the USSR from gaining militarily from joint ventures with U.S. and other Western firms, the U.S. must enforce rigorously the Western ban on selling or transferring to the Soviets militarily useful products. This is the so-called CoCom List, devised by the Coordinating Committee for Multilateral Export Controls consisting of all NATO countries, minus Iceland and including Japan. U.S. firms must be put on notice that they will be held responsible and penalized for any transfer of CoCom products to the Soviets.

No Bailouts.—The Reagan Administration also must advise U.S. firms explicitly and unambiguously that they must view joint ventures with the Soviets as a purely commercial undertaking in a developing country. Contracts may not be enforced, currency controls suddenly may be imposed, labor rules may be modified, and other key assumptions upon which the deal rests can be changed abruptly. As such, it should be stated emphatically, the U.S. government will not underwrite, reimburse, subsidize, bailout, or in any other manner aid a U.S. firm whose business in the USSR fails or falls short of expectations.

What Are Joint Ventures?

Over the years, a variety of cooperative business arrangements have been concluded between Western businessmen and the so-called nonmarket economies of the Soviet bloc and the People's Republic of China.[2] Joint ventures are a specialized type of commercial enterprise. An "operating joint venture" is defined as a partnership through which two or more firms create a separate entity to carry out or manage a productive economic activity.[3]

The essential characteristics of joint ventures are: 1) an agreement on common long-term objectives, such as production, purchasing, sales, maintenance, repair, research, consultations, financing; 2) pooling of assets such as money, plant, machinery, equipment, management know-how, intellectual property rights, which are called capital contributions; 3) creating a management structure; and 4) sharing of profits and risks, with liabilities being normally limited to capital contributions. Combustion Engineering, Inc., of Stamford, Connecticut, for example, will be investing some $16 million initially and will own 49 percent of a partnership with the Soviet Ministry of Oil and Petrochemical Industries in a joint venture that will develop process control systems for refiners. Most of the employees will be Soviet, although the top management will be American. On the venture's board are three Russians and two Americans; its director general, or chief executive, will be Russian.

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[2] These have included turnkey projects, license purchases, and different kinds of industrial cooperation. See Morris Bornstein, The Transfer of Technology to the USSR (Paris: Organization for Economic Cooperation and Development, 1985), ch. 3.

[3] East-West Joint Ventures: Economic, Business, Financial and Legal Aspects (New York: Economic Commission for Europe, United Nations, 1988), p. 1. Other commonly used names to designate such entities are "corporate joint venture" and "interfirm cooperation agreement."

Visions of a Vast Soviet Market.—The principal incentive for American businesses to engage in joint ventures appears to be the potential profit in sales to the vast number of Soviet consumers. Sarah C. Carey, a Washington-based lawyer who has represented U.S. corporations negotiating joint ventures in the USSR, told the House Committee on Foreign Affairs Subcommittee on Europe and the Middle East on April 20, 1988, that such ventures are "permitting U.S. companies to penetrate the Soviet economy, to directly access potential business partners, suppliers, customers" and offer them "a preferred supplier role in many industries." While often insisting that trade and politics be kept separate, U.S. promoters of such ventures also argue that it makes good political sense to purs4ue closer relations and detente and that economic ties can help achieve these objectives.[4]

Soviet Objectives in Pursuing Joint Ventures

The severe problems of the Soviet economy and the sharp drop in prices of Soviet oil exports have prompted the USSR to open its economy to Western joint ventures. Oil and gas amount to about two-thirds of total estimated annual Soviet hard currency income.

Pentagon and Central Intelligence Agency experts suggest that "Moscow sees [joint ventures] as better vehicles than current trade and economic relationships for acquiring and assimilating Western technology, managerial expertise, and marketing skills. As part of Gorbachev's modernization drive, joint ventures are intended to upgrade Soviet production processes and thus spur exports of manufactured goods, reducing Moscow's reliance on energy and other raw materials as its principal foreign exchange earners." [5]

Relying on Raw Materials Exports.—The primary objective of the Kremlin is to increase Soviet exports; joint ventures now account for only 15 percent to 30 percent of Soviet bloc exports to the West. One-third of these ventures export machinery and equipment, one-third export consumer goods, and the rest market either raw and semi-processed materials, such as oil, oil products, and pharmaceuticals, or technology, know-how, and licenses. The Soviets are trying to develop a diversified base of exportable manufactured goods to reduce their huge reliance on raw materials exports.

Soviet Joint Venture Regulations

Regulations give the Soviet partner control of joint ventures. The 49th Decree of the Soviet Council of Ministers for 1987 stipulates that the Soviet share in the statutory capital of the joint venture must not be less than 51 percent.[6] Both the chairman of the board and the director general must be Soviet citizens. The decree, in fact, stipulates that the personnel shall consist "mainly of Soviet citizens." Pay and benefits of foreign employees are to be settled in the employment contract, and Soviet law applies to all foreign citizens employed by the joint venture.[7]

Credits on commercial terms may be obtained by joint ventures in foreign currency from the USSR Bank for Foreign Economic Relations or, with that bank's consent, from foreign banks and firms and in rubles from the USSR State Bank or the USSR Bank for Foreign Economic Relations. Liberalizing Decree 49, Decree 1704, introduced by the Council of Ministers in September 1987, stipulates that joint ventures may determine, in agreement with Soviet enterprises and organizations, both the currency to be used in purchases and sales and the manner in which these purchases and sales are effected. Finally, the regulations state that disputes involving joint ventures are to be settled according to Soviet rules either by Soviet courts—whose standards for legality differ significantly from those of their Western counterparts—or by common consent of the parties in arbitration.[8]

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[4] See Margaret Chapman, ed., Forum on U.S.-Soviet Trade Relations (Washington, D.C.: American Committee on U.S.-Soviet Relations, December 1987), notably papers by James H. Giflen, Hodding Carter III, and Donald Kendall.

[5] CIA and DIA Report, op. cit., p. 41.

[6] The Soviet partner is almost always a state-owned enterprise. Yet there are some exceptions: the new private cooperatives that are now possible under Gorbachev's reforms may, at least in theory, take foreign partners in some aspects of their activities, as in a reported venture between a Finnish firm and an Estonian clothing cooperative. See Jerry F. Hough, Opening Up the Soviet Economy (Washington, D.C.: The Brookings Institution, 1988).

[7] See Alan B. Sherr, "Socialist-Capitalist Joint Ventures in the USSR: Law and Practice," Providence: Brown University, Center for Foreign Policy Development, May 1988).

[8] It is instructive to compare Soviet regulations on East-West joint ventures with those of the Chinese. In China, there are no limits to the share a foreign company may own. Some Americans operate wholly owned subsidiaries in China. Perhaps the most significant Chinese reform is

Continued

Initial Western Response to the Joint Venture Option

There are now relatively few Western, and in particular U.S., joint ventures with Soviet bloc countries. At the end of 1986 there were only about 400 Western joint ventures with Soviet bloc shareholders.[9] Soviet bloc investment in these companies amounts to less than $500 million—only a small portion of this amount representing hard currency.

Since the Soviet decree of January 1987 permitting joint ventures with Western companies, only about 36 have been formally registered. Of those, only five are American: Combustion Engineering, Inc., of Stamford, Connecticut, for the development of process control systems for refineries; Management Partnerships International of Chicago, for the assembly of computer hardware and the development of computer software; Honeywell, -Inc., of Minneapolis, for automating Soviet fertilizer plants; Occidental Petroleum Corporation of Los Angeles, for two plants to make polyvinylchloride, a widely used plastic, in the Ukraine; and IDG Communications, Inc., of Framingham, Massachusetts, for a publications agreement to publish the first computer technology magazine in the USSR.

Whether joint ventures are to provide a new commercial avenue of any significance with the USSR remains to be seen. It is likely to be pursued mainly by companies with extensive experience in dealing commercially with Moscow and high-level contacts in the USSR. To take advantage of such experience, several companies have created the American Trade Consortium, which in April 1988 signed a Protocol of Intentions with its Soviet counterpart, the state-operated Soviet Foreign Economic Consortium. Consortium members may be able to obtain concessions from the Soviets that will facilitate joint ventures. For example, Consortium members will be exempt from the Soviet requirement that each joint venture must cover all of its expenses in hard currency before it can recover any hard currency profits on the world market. Membership in the Consortium reportedly costs $1 million.

Floppy Disks and Sweeteners.—Mercator Corporation President James H. Giffen is President of the Consortium. He reports that Archer Daniels Midland Company is negotiating joint ventures in agricultural processing with the Soviet Ministry Gosagroprom. Oil processing, edible oil refining, and the production of starch and sweeteners are under discussion. Chevron Corporation is discussing oil exploration and development. Eastman Kodak Company expects to manufacture and market floppy disks for personal computers and blood analysis equipment. Ford Motor Company will continue discussions on automobile manufacturing started in mid-1987. Johnson and Johnson is considering the production of pharmaceuticals. RJR Nabisco, Inc., plans to produce tobacco, cracker and biscuit products, and cereals, as well as food manufacturing processes. Mercator Corporation has emerged as the Consortium's financial manager after a reportedly controversial competition.

PROBLEMS FOR THE WEST WITH JOINT VENTURES

Past Soviet Unreliability

The history of U.S. commercial involvement with the USSR should make American businessmen cautious. Western business with the Soviets began in 1921 with Lenin's New Economic Policy. Prompted by grave economic problems—Russian industry having essentially ceased to function—Western capitalists were invited to help with industrial reconstruction. In the late 1920's, the Ford Motor Company constructed a huge integrated plant at Gorky to build Model A cars, trucks, and buses. General Electric Company helped develop the Soviet electrical industry. The E.L. du Pont de Nemours and Company, Inc., introduced technology to the chemical industry. and RCA Corporation, to the communications industry.

During the 1930's, the McKee Corporation of Cleveland designed the Magnitogorsk steel mill, a copy of U.S. Steel's plant at Gary, Indiana. All the refineries in the Soviet Union's principal oil-producing area at Baku were constructed by American firms, which also furnished the bulk of the drilling and pumping equipment. By 1935, however, most American companies were expelled.

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the "special economic zones" (SEZ) concept introduced in 1979, which reduces customs duty, income taxes, rent, utility charges, and wage rates of selected border areas. By mid-1986, the overall effect of Chinese reforms was that China had attracted contracts for $18.1 billion in investment and 2,500 joint ventures, 127 of which were wholly owned foreign corporations. Unless the Soviets are prepared to make similar reforms, there is some doubt that Western partners could ever become involved in joint ventures with the USSR on any similar scale. See Marshall I. Goldman, Gobachev's Challenge (New York: W.W. Norton & Company, Inc., 1987), ch. 7.

[9] East-West Joint Ventures, op. cit., p. 22.

Burdensome Financial Obligations

The Soviet tax rate on the profits of joint ventures is a high 30 percent. This is in addition to a 20 percent tax on the foreign partner's share of profits that is transferred abroad. What is more, the joint venture is required to allocate resources to such funds as are deemed "necessary for its operation and the social needs of its personnel." This last category is particularly disquieting because of the broad definition of social development funds in the context of Soviet enterprises. Published in the Soviet newspaper Izvestiya on July 1, 1987, the Law on State Enterprises defines social funds to include financial contributions "used by the labor collective for housing construction, for strengthening in every possible way the material and technical base of the social and cultural sphere, the upkeep of facilities in the sphere, the implementation 'of health service and mass culture measures, and the satisfaction of other social needs."

Bureaucratic Roadblocks

Stories abound about the difficulties of dealing with the Soviet bureaucracy. For example, West German publisher Burda Verlag, who introduced a Russian language version of a Burda magazine for women in March 1987, was unable to complete a joint venture deal because, after months of talks, according to Burda's general manager Manfred Made, the Soviets still could not answer questions about how the project was supposed to be financed or make profits.[10] And according to Alan B. Sherr, Director of the Project on Soviet Foreign Economic Policy and International Security at Brown University, "Western managers who on efficient and reliable means of communication will be frustrated by Soviet reality.[11] Telephone service is of low quality and unreliable—telephone books virtually unknown. Computer facilities, facsimile machines, and even telex equipment are relatively scarce. Business travel is difficult because the Soviet airline, Aeroflot, offers poor service. Hotel accommodations are scarce. Lack of office space and housing for Western personnel is especially serious, although some adjustments reportedly are being made.

Recovering Hard Currency

To meet its hard currency expenses, such as salaries for foreign employees and imports of some components, a Western partner must either be able to convert rubles to hard currency or earn hard currency, generally through sales outside the USSR. According to Decree 49, all foreign currency expenditures of a joint venture must be covered by proceeds from sales in foreign markets. This means that hard currency earnings first must be applied to cover hard currency expenditures. Only then can profits be repatriated in hard currency. Soviet regulations, moreover, are vague about profits earned in rubles, and it is not clear whether and if so, at what exchange rate, such profits can be repatriated.[12]

Nonconvertibility of the Ruble

The fact that the ruble is not convertible, that is, cannot be exchanged on the world market—and hence is useless as currency except in the USSR—is perhaps the most significant obstacle to joint ventures with the USSR. Among the questions raised by convertibility are: How much should be paid for Soviet labor and raw materials? How much should be charged Soviet customers? How should the venture evaluate the land and other noncash items contributed by the Soviets as part of their 51 percent of the venture's equity capital? How much profit should be excluded from dividends in a required reserve for so-called social development?[13] Since the official exchange rate for the ruble overestimates its real value by as much as four times,[14] the Soviet contribution to the joint venture as well as other payments can be overestimated.

Some businessmen seem to believe that the Soviets will turn to a convertible ruble in the near future.[15] Yet there is no evidence of this. As the Kremlin prob-

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[10] Peter Gurabel, "Soviet Plan to Let in Foreign Firms Proves Frustrating in Practice," The Wall Street Journal, July 17, 1987.

[11] Sherr, op. cit., p. 42.

[12] "Venturing Jointly into the Russian Unknown," The Economist, June 6, 1987.

[13] Theodore C. Sorensen, "The West Can Do Business with Soviets," The Wall Street Journal, December 28, 1987.

[14] Sherr, op. cit.

[15] Testimony by Michael R. Bonsignore, President, Honeywell International, before the Commission on Security and Cooperation in Europe, May 10, 1988: "As you know, it is an important goal of the Eastern Bloc to achieve free market economies by about 1990, and ultimately fall convertibility of the currencies by the mid-1990's."

ably understands, one likely result of turning to convertibility, and hence, a pricing mechanism, would be severe inflation as prices for goods in short supply (the vast majority) would immediately rise. The political effects of such policies might well be severe.[16]

Uncertain Access to Soviet Domestic Markets

While the Soviets want to become sellers on the world market, Westerners would like to sell their products in the USSR. These differing objectives of the partners in joint ventures are viewed by many experts as incompatible.

Legal System

Joint venture regulations require that disputes are to be settled according to Soviet rules either by Soviet courts or by common consent of the parties, in arbitration before a Soviet arbitration tribunal. The Soviet legal system lacks Western constitutional safeguards and is often arbitrary and dominated by Soviet political authorities. There is little precedent in Soviet law to guide Western businesses.

Increasing Hard Currency Earnings

A portion of the costs of Soviet expansionism throughout the world requires hard currency. As such, joint ventures that increase Soviet hard currency earnings have implications for U.S. security. In 1986, the USSR reportedly spent over one-third of its hard currency earnings to prop up Cuba, Nicaragua, and Vietnam and for intelligence activities.[17]

Relationship between Soviet Economy and Internal Reform

Internal reform of the USSR is difficult and fraught with political risks, particularly concerning military spending. Gorbachev surely would prefer to fix his country's economic problems by tampering as little as possible with centralized economic control, and in particular with the currently high military budget. According to former National Security economic advisor Roger Robinson, major infusions of Western capital, equipment, and technology into the Soviet Union typically have not stimulated change but have substituted for genuine economic reform. Joint ventures could provide a "fix" that would preclude more serious economic reform, especially in shifting defense resources. Former Assistant Secretary of Defense Richard Perle and Soviet dissident Vladimir Bukovsky suggested at a conference on the USSR on June 9, 1988, a view that already had been stated by the Central Intelligence and the Defense Intelligence Agencies that "Gorbachev probably would be reluctant to leave himself open to charges of weakening Soviet defense pushing reforms or resource shifts that many in the military leadership oppose." [18] Continuing severe economic problems, however, might require Gorbachev to shift resources from the military to the domestic sector, thereby reducing Soviet military prowess vis-a-vis the West.

Increased Technology Transfer

In the 1970's, the USSR emphasized "active" technology transfer mechanisms through commercial cooperation agreements, such as turnkey plants, whereby a Western company would build an entire factory. This is distinct from "passive" buying of licenses and importing ready-made Western goods. Assimilation of Western technology has been easier in the active cooperation mechanisms. Joint ventures, of course, are an active technology transfer mechanism and, in fact, the most effective means of assimilating Western technology, in part through extensive Western management. This is particularly dangerous in the area of computer technology. Pentagon officials are very concerned about the military applications of management techniques learned from Western partners in joint ventures.

Intelligence Risks

Individual U.S. businessmen and scientists involved in joint ventures are sure to be targets for the Soviet intelligence services. Deputy Assistant Secretary of Defense David Wigg told the Congressional Joint Economic Committee on September 10, 1987: "The opening up of East-West commercial ties would provide a windfall for the Soviet and East European intelligence services and their technology acquisition

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[16] Goldman, op. cit., ch. 8.

[17] According to former National Security Council economic advisor Roger Robinson, Western credits used for the purpose of equity contributions to such enterprises are not added to the USSR's total indebtedness, which results in a potentially misleading financial picture.

[18] CIA and DIA Report, op. cit., p. 33.

programs." [19] Business visitors from the USSR, moreover, will travel to the U.S. under private sector auspices. Warned Wigg: "Many of these visitors would be working for the KGB [Soviet Secret Service] or GRU [Military Intelligence]. No mechanism exists in the U.S. government to evaluate the security risks associated with business visitors from the USSR." The Soviets may well obtain access to sensitive data during the course of doing business.

Consolidation of a Pro-Soviet Lobby in the U.S.

American businessmen involved in joint ventures may tend to think more about the security of their investments than about long-term U.S. foreign policy and national security concerns. Perhaps the most influential organization of the pro-Soviet trade lobby is the U.S.-USSR Trade and Economic Council (USTEC), an organization composed of roughly 400 major American corporations and Soviet government trade enterprises. The list of USTEC members has not been made available to the U.S. government—despite offers to classic it so as to protect the members' privacy—although it is available to the Soviets. A USTEC co-chairman from 1977 to 1984 was the current Secretary of Commerce, C. William Verity, Jr., who then worked closely with USTEC executive committee member Yevgeny Pitovranov. Pitovranov was identified in 1983 by intelligence expert John Barron as a KGB lieutenant general. Verity has become such an uninhibited booster of trading with Moscow that he personally led the delegation of 500 American businessmen to the USSR this spring.

Some USTEC members are representatives of the USSR Chamber of Commerce and Industry, which maintains ties to the Soviet military intelligence agency, GRU. One-third of the Chamber's 140 employees are known or suspected Soviet secret service officers. Declassified portions of a recent Central Intelligence Agency investigation reveal that the USSR Chamber of Commerce and Industry is a center of Soviet industrial espionage "while acting as a trade promoter and facilitator with excellent access to Western firms." [20]

Yet USTEC's influence seems to be increasing. At the December 1987 U.S.-Soviet Summit, Verity invited two USTEC executives to an unpublicized meeting with Gorbachev. USTEC has lobbied extensively in favor of joint ventures. Recent issues of USTEC Journal reportedly indicate the interest of U.S. business executives in the prospects for this new form of cooperation with the USSR.[21]

CONCLUSION

Joint ventures between American companies and the Soviet Union are not likely to mushroom immediately. The reasons are mainly economic: U.S. businesses will balk at regulations requiring that the Soviets retain at least 51 percent of the statutory capital of a joint venture and that both the chairman of the board and the director general be Soviet. The nonconvertibility of the ruble, meanwhile, raises questions about the prices that the joint venture can charge, how much profit should be excluded from dividends, how much should be paid for Soviet labor and raw materials, and above all how the venture can bring hard currency profits back to, the West. In addition, there are predictable bureaucratic roadblocks and questions about how to reach the Soviet customer.

Military Risk.—Nevertheless, national security concerns are growing rapidly and require immediate U.S. government attention. Increasing Soviet hard currency earnings—Moscow's principal reason for undertaking joint ventures—make more money available for foreign adventurism in Angola, Cuba, Nicaragua, and elsewhere, as well as for domestic oppression. To the extent that joint ventures help the Soviets improve their economy without having to reduce military outlays, they actually increase the tllreat to the West by creating an economically stronger and more dynamic adversary. By reducing General Secretary Gorbachev's need to introduce fundamental structural changes in the Soviet economy, moreover, there is less incentive to reduce the Soviet defense budget in the immediate future. Finally, there is an intelligence and technology transfer risk when Western companies with access to sensitive information begin dealing with Soviet officials, many of whom are likely to be intelligence officers.

In light of the economic problems that joint ventures with the USSR will probably face, the Reagan Administration must advise U.S. firms explicitly that they must view joint ventures with the USSR as a purely commercial undertaking with all the

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[19] See U.S. Department of State, Intelligence Collection in the USSR Chamber of Commerce and Industry, 1987, for an analysis of Soviet methods of technology acquisition.

[20] Ibid.

[21] Ira Caruahan, "USTEC: Determined to Sell Moscow the Rope That Could Hang America," Heritage Foundation Institution Analysis No. 39, February 5, 1988.

attendant risks. Under no circumstances should the U.S. government underwrite, reimburse, subsidize, or in any other manner aid a U.S. firm whose business in the USSR falls or otherwise encounters financial difficulties.

Enforcing CoCom.—In order to prevent the Kremlin from gaining militarily from joint ventures, moreover, the U.S. must rigorously enforce the Western ban on selling or transferring to the Soviets militarily useful products. The list negotiated with Western allies who are members of CoCom, the Coordinating Committee for Multilateral Export Controls, should be strictly enforced, and U.S. firms must be put on notice that any transfer of CoCom products to the Soviets will be severely penalized.

[The Washington Times, Apr. 11, 1989]

High Tech Transfer Pressure

(By Juliana Geran Pilon)

It is heartening to know that the recent incident involving a 34-year-old West German computer hacker did not compromise NATO intelligence. But it could have been worse for, according to several West German-based security experts, West German authorities have been very slow in responding to reports since late 1987 that sensitive Western computer banks are susceptive to penetration. This attitude is indicative of seeming unwillingness, at the highest levels of the German Government, to take seriously national security threats to the West.

This attitude, too, appears to have inspired a very high-level delegation of West German officials who recently came to Washington to urge the United States to change its current stringent policy regarding strategic controls of direct West-East exports.

Specifically, the West Germans want the United States to give them the green light to export even more of their high-technology equipment to the U.S.S.R., but without the stigma of illegality.

The current U.S. attitude, known as "the no-exceptions policy," is in effect to adhere strictly—that is, ask for no exceptions—to the list of controls agreed to by the Coordinating Committee for Multilateral Export Controls (COCOM), which consists of Japan and all the NATO allies except Iceland. That policy was institutionalized by Ronald Reagan following a Presidential order issued during the Carter administration in 1979 after the Soviet invasion of Afghanistan.

Thus far the United States has consistently held firm to the no-exceptions policy in COCOM. This has prevented the Soviets over time from acquiring turnkey plants and critical know-how needed to upgrade their weapons systems. Export control over direct licensing to the Soviet Union has forced it to acquire strategic technology illegally through a number of free world countries. These targeted technologies and commodities include computers, microelectric production equipment, machine tools, deep underwater equipment, telecommunications technology and sophisticated work stations for the design, manufacturing, and engineering of weapons systems.

But West Germany has taken the lead among Western allies in consistently objecting to most of COCOM's licensing procedures as too cumbersome—apparently more interested in profiting from the Soviet market than in Western security. Yet, ironically, U.S. Government analysts estimate that West Germany is probably the greatest single source of illegal transfers of sensitive technology to the Warsaw Pact and is a major supplier of chemical weapons, nuclear, and missile technology to Third World countries. Many of these countries have foreign policies inimical to those of the United States and indeed the Western alliance.

The problem is endemic in the West German control system. For example, West German officials do not conduct prelicense or post delivery checks to ensure that products reach legitimate end-users in other free world countries. An excellent illustration of the kind of problem that arises as a result dates from 1987, when a group of very sensitive computer-aided manufacturing stations were about to be divested from West Germany. The stations had been cleared by German licensing authorities to a Belgian front company, which in turn was orchestrating the diversion through an Austrian transit zone into Hungary. The operation was quite sophisticated. The work stations had gone through at least two front companies in West Germany before being exported to the Belgian front without any detection. But since there had been neither predelivery nor end-user checks, the operation nearly succeeded.

West Germany, moreover, does not require an import certificate from an importing country to ensure the protection of sensitive exports from illegal diversion. Unlike U.S. law, German law lacks a conspiracy provision, which means that a

German company can order embargoed commodities—such as strategic commodities and chemical warfare equipment—from one country and have them shipped to another country without touching German soil, and never by punished for it.

German law also does not permit a thorough investigation of a company's records without a court order—and a court order cannot be obtained without substantial evidence that the firm was involved in a diversion—a catch-22 situation bound to result in massive violations. And to make matters worse, West German authorities do not usually require an import certificate from the importing country to ensure the protection of sensitive exports.

Finally, there is no adequate coordination between the different German agencies involved in regulating technology transfer. COCOM controls, therefore, are not properly implemented. A fairly typical case took place last year, when German licensing authorities mistakenly approved the export of a minisubmarine, the Seahorse, by the Bruker Meerstechnik company to North Korea. The license had been approved by German licensing authorities with insufficient checks among the relevant agencies. When the United States learned of the license approval, it insisted that tests be performed to check whether the item was covered by COCOM munitions regulations—as indeed it was.

since the company had already received a license to ship, the West German taxpayer was obligated to pick up the tab to purchase the contract, because the company threatened to sue.

The vast majority of such cases do not see the light of print, the information being restricted to Government officials and Congress, or buried in legal documents, but a few do become public. One notorious example of an intercepted illegal sale took place in 1985, when a microdensitometer was stopped on the East German border after the United States Government had turned down two license requests to export the item to the U.S.S.R.

The item, which is used in highly specialized nuclear work in streak photography, was being shipped from a German company. Customs officials found the paperwork suspicious and detained the item, only to discover that it was indeed embargoed by COCOM.

Yet neither this nor any other similar incident prompted Germany to modify its legal system to comply with its obligations to the allies' economic agreement.

It is not a little disturbing that West Germany is pressing for changes in U.S. trade policy on strategic trade at the same time it is involved in major diversions to the bloc, and given its history in the business of chemical warfare.

Nor does it make much sense to reward the Soviets for having left Afghanistan. For the Soviet military continues to pose an enormous threat to the West, a threat which would be seriously increased if high-technology equipment to the Soviet bloc, indeed urge it to support the more stringent regulations mandated by the sale of sensitive tunnel-boring and shaft-sinking equipment.

[The Wall Street Journal, Sept. 6, 1988]

Technology Leaks in Soviet Joint Ventures

(By Juliana Geran Pilon)

Washington.—The recent thaw in relations with the Soviet Union has generated considerable interest in commercial joint ventures between Western and Soviet enterprises. One problem with joint ventures, however, is that without monitoring they can easily become vehicles for transferring Western technology to the Soviet Union. The trouble comes when the technology in question is the kind ordinarily prohibited by the Coordinating Committee for Multilateral Export Controls.

Founded in 1949, COCOM includes Japan and all countries in the North Atlantic Treaty Organization, except Iceland. Among other activities, the Paris-based organization keeps track of high-technology items barred from sale to the Soviet bloc because of their strategic implications. But COCOM has not specified sufficiently clearly how the list is to apply to joint ventures. The result is dangerous ambiguity.

The West German Government, for example, recently decided to test the COCOM loophole, and announced a new joint venture with Moscow in an extremely sensitive area: machine tools. The German firm Wendt and the Soviet MSZ Production Amalgamation plan to jointly manufacture automatic grinders in Moscow. By 1990, the venture is expected to produce some 30 tools in 3 models for working hard-alloy plates. The problem is that West German machine tools are the most sophisticated

in the world, supplying both the United States and Japanese defense industries. Depending on their degree of accuracy, these tools can improve the quality of a large variety of Soviet military hardware including jets and missiles.

GENEROUS FINANCING

Indeed, the Germans are thumbing their noses at COCOM. The German-Soviet machine tool agreement took place after COCOM countries had agreed in a January meeting this year at Versailles to toughen up their regulations requiring member governments to issue licenses for sophisticated machine tools being exported to the Soviet bloc. The regulations had come about in part because West German machine tool shipments to East Germany had increased in 1987 by 269 percent to $403 million. Bonn had argued then that no export licenses were required—even though the tools were reexported to the Soviet Union. COCOM's response was prompt. Yet West Germany not only went on to double its exports but even found a loophole in joint ventures, and is now evidently taking advantage of it.

The project is getting generous financing, too. At the 16th session of the bilateral Mixed Economic Commission on Economic, Scientific and Technological Cooperation, held in Moscow in May, a $2.2 billion line of credit was toasted by participants. Financed by a consortium of West German banks, the line of credit is reportedly being backed by the West German Government. Reports following the May meeting indicated that industry is hoping for a sharp increase in Soviet orders as a result of the line of credit.

The Germans appear to be altogether unmoved by the recent scandal involving the French machine tool industry. Four executives of the bankrupt Machines Francaises Lourdes and its former Forest Line subsidiary are currently in jail for illegally shipping six axis milling machines to the Soviet Union. The tools are used to manufacture turbines for military jets. Jean Mayot, the new general manager of the French Machine Tool Manufacturers Association, feels the case gave a "very healthy warning signal to the industry."

The warning also appears to have been missed in Italy. While direct exports of Italian machine tools to the Soviet Union increased only 15 percent in 1987, to $64 million, the Italians have their own scam. According to officials of the Italian Machine Tool Manufacturers Association, Italian-made machine tools are routinely shipped to a number of Indian trading companies that have built a thriving business reexporting them to the Soviet Union. India, meanwhile, appears to be benefiting: the June 23 issue of Soviet Business and Trade, a Washington newsletter published by Welt Publishing Co., notes that the Soviet Union will build a massive nuclear power plant in southern India. "Moscow is offering generous terms which will result in a considerable Soviet subsidy of the plants' construction," the report said.

The United States, so far, has been strangely silent about the joint ventures loophole, though there are assurances that the issue will be on the agenda of the bilateral Washington-Bonn talks scheduled for next month in Germany.

The United States must first get its own house in order. For even as Defense Department officials are expressing concern about the national security implications of joint ventures, the Commerce Department—notably Commerce Secretary C. William Verity, Jr.—appears to be going all out to encourage such enterprises.

Since a new Soviet law went into effect in January 1987 permitting joint ventures with Western companies, five United States firms have signed on: Combustion Engineering, Stamford, CT, for the development of process control systems for refineries; Management Partnerships International, Chicago, for the assembly of computer hardware and the development of computer software; Honeywell, Inc., Minneapolis, for automating Soviet fertilizer plants; Occidental Petroleum, Los Angeles, for two plants to make polyvinylchloride, a widely used plastic; and IDG Communications, Framingham, MA, to publish the first computer technology magazine in the Soviet Union.

National security questions already have arisen, primarily because it is not clear whether U.S. export control regulations apply to management know-how as well as specific technologies. Management Partnerships International, for example, intends to apply management expertise to areas that would help the Soviets update technologies now embargoed by the West. Yet the project might move forward, despite reservations from some Government agencies. "It depends whether you read the regulations broadly or narrowly," says one administration official. "And especially with Verity now in command, the tendency is to read them very narrowly."

In addition to the specific transfer of technology and know-how, there are other security concerns as well. To the extent that they assist the Soviet economy, particularly by improving Soviet gas and oil exploration capabilities, joint ventures

thus permit Moscow to increase it hard currency, which is need to finance the rest of its empire.

Finally, because joint ventures put the Soviets in direct contact with United States businessmen and scientists, there are increased possibilities for espionage and other mischief. It is no accident that some members of the United States-U.S.S.R. Trade and Economic Council, known as USTEC, belong to the U.S.S.R. Chamber of Commerce and Industry, many of whose employees are known KGB intelligence officers. Declassified portions of a Central Intelligence Agency investigation identify the Chamber as a center of Soviet industrial espionage "while acting as a trade promoter and facilitator with excellent access to Western firms."

Commerce Secretary Verity himself was cochairman of USTEC from 1977 to 1984. At that time Mr. Verity worked closely with USTEC executive committee member Yevgeny Pitovranov, who has been identified by Sovietologist John Barron as a KGB lieutenant general. But Mr. Verity seems unconcerned. On the contrary, he is seeking a Cabinet consensus to vigorously encourage joint ventures with the Soviet Union.

SECURITY FIRST

Secretary Verity is right at least in one respect: There is currently no clear U.S. policy on joint ventures. Such a policy should be formulated, and soon. But rather than go in the direction of business at any price, the United States should put security first.

If the United States is serious about technology transfer, it should take the lead on this issue, showing its allies that it cares about the national security implications of joint ventures. The United States should not only make sure that COCOM procedures on joint venture review are clear, and enforced, but immediately express its strongest concern about the irresponsible way in which certain Western nations, particularly West Germany, have thrown all caution to the wind. For whether or not General Secretary Gorbachev is ready for a new detente, this is no time for the West to relax its guard. After all, it may just be that glasnost's main objective is simply to lure us into high-technology complacency.

Prepared Statement of David G. Wigg of the National Forum Foundation

CONSIDERING NATIONAL SECURITY IN EAST-WEST TRADE POLICY

INTRODUCTION

Until very recently, Moscow's Communist Elite have been ruling the Soviet Union as though they were a huge mafia, but with the important added governmental advantage of diplomatic privilege. Historical malevolence toward the Soviet population, single-minded preoccupation with weapons competition and policies aimed at regional and global aggression lend credence to this view of the Soviet Leadership (as does Kremlin intrigue). It also might account for the remarkably careless, wasteful civilian economic policies and practices that have brought Moscow to the brink of societal disaster.

For seven decades, successive Soviet leaders have perpetuated ideologically-driven, militarily-focused economic and investment policies in Moscow's determination to build the world's most powerful military force as the principal tool of its foreign policy. Unfortunately for Moscow economic strength in this world is relative, and the Industrial West sustained a superior economic performance, which left the Soviet Leadership constantly struggling to acquire and absorb superior Western technological change fast enough to keep Moscow from falling too far' behind the West's rapidly advancing industrial development.

Soviet attempts to catch up with (let alone surpass) the West have failed. The final East-West battle of the economic portion of the Cold War, initiated by Stalin at the end of World War II and perpetuated by Khrushchev and Brezhnev is over—NATO has won. The West has been far ahead for over thirty years, but the disparity coupled with East-West hostility had become such a liability by the mid-1980's that Gorbachev was forced to throw in the towel. Because of the inherent superiority of democratic capitalism, the Soviets will, for the foreseeable future, remain relatively backward and heavily dependent on the West for essential technological inputs and "bright ideas."

The appearance of a "Gorbachev type" was inevitable. Under long-term, East-West competitive stress, the pre-1985 brand of Soviet decisionmaking was untenable and would have led to the further weakening and eventual collapse of the economy.

Assuming continued Western economic dynamism, Moscow's failure to respond vigorously (and successfully) to its economic crisis would lead eventually to the decline and dismemberment of the Soviet empire. Thus, Stalin's post World War II dilemma—how to develop and modernize under the Soviet prescription while carrying on an adversarial relationship with the West and yet function proactively around the world to expand Soviet influence—had, by the mid-1980's evolved into Gorbachev's distress.

In spite of this good strategic economic news, certain circumstances and poor NATO policies are converging to the West's potential disadvantage. My comments today will address what I consider to be wrong-headed East-West economic policies, their potential cost to NATO if left unaddressed and some corrective suggestions.

NATO'S Flawed Policies and Unacceptable Risks

In the excitement over Perestroika and Glasnost, some NATO government officials seem to have lost sight of the underlying fundamentals of the East-West relationship that argue for a far more conservative approach to both strategic and commercial dealings with Moscow. Many argue that the "new" Soviet outlook represents a major shift and that Moscow's strategic/foreign policy goals have changed from global aggression and the use of brute force to achieve its aims to inward-looking reforms and "refined" foreign policy, emphasizing international cooperation. If Soviet strategic goals have indeed changed, I submit it is due, not to a religious conversion, but to the fact that NATO has removed Moscow's historical ambitions of global domination from the realm of the possible.

Economic Strength Equals Security

It is indeed ironic that we accomplished this unprecedented feat by merely doing what comes naturally—pursuing democratic capitalism. Western economic progress has become a massive juggernaut advancing inexorably on Comecon inferiority and greatly complicating Moscow's attempts to retain military parity—only achieved by stealing the West's technical genius that Comecon could not duplicate and by squandering resources on relatively massive quantities of military hardware to compensate for its remaining technological inferiority. If Gorbachev had not reached out to the West, the Soviet economy would have eventually been (and, in any case, may yet be) relegated to history's trash heap of economic inferiority, technological backwardness and resource exhaustion. Thus, the development of the industrial West's economic strength has served not only to bring unparalleled prosperity, it has also served as NATO's first line of defense against Soviet-Bloc aggression.

A key (and currently debated) element of the Soviet and Western policy debate over Perestroika is whether and how the Soviets might achieve double convertibility. Currency convertibility (particularly its acceptance as a store of value) is the ultimate mark of a country's economic prowess in the global economy. It is accorded to those currencies judged by world financial markets to be most in demand, and hence from the most competitive, durable and stable economies. As with NATO's relative industrial strength, the lack of currency convertibility in the Soviet Bloc has served as one of the West's most potent (if inadvertent) defenses against the spread of the Soviet empire and other Soviet activities inimical to Western interests, by raising the opportunity costs of all Soviet hard currency spending decisions. For example, the negative strategic impact on the Soviets of the fall in the world price of one commodity—oil—and the convertible (hard) currency losses resulting therefrom has, in my view, been greater than the effects since 1980 of all of NATO's diplomatic and military policies combined. In sum, the relatively more successful economic development of the Western community of nations that has left the dangerously aggressive Soviets "on the outside looking in" and locked in a debilitating resource wasting economic system with a non-convertible currency, has served us well as a crucial (if de facto) element of NATO's security. In that regard, Western economic institutions (the World Bank, IMF, GATT, etc.) and the global cooperation embodied therein, are integral elements of the West's economic strength and their essential cohesion must be carefully preserved. Soviet membership in such organizations should not be considered cost-free to be traded in return for human rights or other concessions. The West has ample experience with the disruption that a determined Soviet presence can create in international organizations. Potential damage to Western security interests could be severe in introducing a hostile, economically indigestible and politically adventurous actor into global economic councils.

Since we are doing so well in the East-West economic competition and since it is too early to gauge the extent of Moscow's purported change of heart, why pursue policies that unilaterally weaken Western security and result in lessening the very pressures on the Soviet system that have brought them near the brink of rethinking fundamental allocational ("guns versus butter") choices? Let's look at some of the

existing and still- formative NATO policies in this area and see if we can answer that question.

Facts and Policies at Odds

One of the most divisive issues swirling around the East West relationship these days has to do with the Western response to Gorbachev's siren-song for expanded trade and commercial ties. I say "siren-song" because Western businessmen have heard and responded to the same "tune" in virtually every decade since the Bolshevik revolution—much to NATO's cumulative disadvantage. The most powerful people in the various NATO governments (including ours) have stated repeatedly that "non strategic" trade with the Soviets is harmless and is in our interest. We might recognize this description of the convergence of our strategic and business interests as the "eighties" East-West version of a statement made in 1953 by Charles Wilson, Eisenhower's Defense Secretary that "* * * what's good for General Motors is good for the United States."

Unfortunately, where East-West trade as presently conducted is concerned, what may be good for business is harmful to the U.S. and the Alliance. This is so because the phrase "nonstrategic East-West trade" is an oxymoron—a statement I will clarify in discussing four concerns: the costs/benefits of the trade and the role of Western business, the importance to the NATO economies of the trade and the management of the trading relationship by diplomatic and trade promotion organs within the NATO governments.

We have already determined that the Soviets have had a longstanding dependence on NATO's (and particularly U.S.) strategic technologies that they must buy or steal. From the time of the Czars the West has played a crucial role in periodically "jump-starting" the Soviet industrial base. Since World War II the Soviet Bloc has purchased thousands of Western "turn-key" plants, legally and illegally making everything from cigarettes to silicon chips which have, in turn, served as prototypes for indigenous production of tens of thousands more.

From what is known of the Soviet dependence on Western know how and equipment, one can legitimately question whether there is any such thing as original Soviet technology, even after 70 years of development (note Gorbachev prowling the West with "jumper-cables" in hand). We have only to Look at successive weapons systems rolling off.Soviet production lines to 'realize how much copying or "informed" weapons counter development is taking place. When Abel Agenbagyan, one of the architects of Perestroika was here with Gorbachev in December 1987, he admitted to Senator Proxmire that the Soviets rely on acquisition of NATO technologies, but he said they don't like it and plan to kick the habit. We cannot blame them; who would want to rely on stealing the ideas of one's adversaries in order to sustain an empire. But that is not NATO's problem.

NATO's Problem

Our problem is that the Soviets so abuse their economic and other ties to the West in order to conduct technology theft, promote illegal trade diversions and practice espionage, as to render the interaction clearly not in NATO's interest. The East-Bloc trading relationships with the NATO business community serve as a key platform for these illicit activities. Soviet Bloc intelligence activities in the West, including those of the KGB, GRU and the East European services are on the rise across-the-board, with a top priority focus on covert acquisition of militarily-relevant technologies. To those who argue for expanded "non-strategic" trade, I ask what kind of modus vivendi can be constructed when, on the one hand Western businessmen are attempting to conduct business, while their Soviet Bloc counterparts are using the access provided by the business process to conduct covert operations targetting sensitive technologies and to promote trade diversion?

President Bush has said, "The competitive strategies approach to defense (standoff weapons, remotely piloted vehicles, stealth systems, etc.) is designed to get us to think smart and to rely upon our advantages in new technologies. This initiative will help give us the conventional improvements we need without busting the budget." Unfortunately, the realities of East-West trading and other relationships may prevent the full benefits of competitive strategies from being realized. How valuable will the development and procurement of these breakthrough technologies be to NATO if the Warsaw Pact acquires and develops the same technologies and fields similar weapons with a minimal lag? As Richard Perle has pointed out in Congressional testimony, virtually every major Soviet weapons system incorporates US, Japanese, German, French, and British technology to various degrees—in many cases, decisively.

The Soviet Bloc has spent decades building their remarkably effective networks for trade diversions and theft by espionage. This, combined with the growth in

Western industrial capacity has made it impossible to stop technology loss, but sharply reducing it must, once again, become our top priority if the President's words are to become a reality. What of NATO's efforts to plug the technology leaks? Despite the heroic efforts of my two colleagues on this panel, COCOM is hardly the panacea for protecting NATO's sensitive technologies that the trade proponents claim it to be.

Hundreds of businesses throughout North America, Europe, Japan, and elsewhere, ignore COCOM restrictions and ship sensitive technologies to the East-Bloc, thereby undermining NATO's technological lead in weapons. The same mentality that engages in the selling of proscribed chemical, biological and nuclear weapons technologies to unstable Third World governments is behind illegal sales to Warsaw-Pact customers, arguably with more damaging result.

To answer the rhetorical question above concerning the cost of losing military technologies, a technology-loss estimate must take into account the discount factor against NATO defense spending (about $450 billion at the moment) commensurate with the relative degradation of NATO weapons due to resulting qualitative Soviet gains. I estimate the annual dollar cost to NATO of technology loss (exclusive of national security loss for which no measure exists except the outcome of war) to range from $15 billion to $40 billion, depending on the technologies and weapon systems compromised in any particular year.

With those numbers in mind, we might ask just how important is NATO's trade with the Soviet Union? Perhaps the export numbers are large enough to mitigate the financial costs of Soviet abuses. It also might explain the massive amount of press "ink" devoted to the subject, not to mention the preoccupation with East-West economics of NATO governments' trade promotion and foreign policy agencies.

In 1987, NATO's exports to the world totaled $1.32 trillion.[1] That same year NATO exports to the USSR totaled $12.9 billion or 0.9 percent of total NATO exports—a sufficiently small number that it could be considered statistically insignificant.[2] It gets worse: If we assume that the overall net profitability resulting from exporting to Moscow averages a reasonable twelve percent of sales for all of the NATO commercial interests concerned, it amounts to around $1.5 billion or one-tenth of my low estimate for the annual cost of technology loss and one twenty-sixth of the high estimate—hardly an impressive cost/benefit outcome for the national interest.[3]

In considering these remarkably high negatives associated with East-West economic interaction, we could ask: Cuibono, or who benefits other than the Soviets? The principal Western beneficiaries appear to be the few firms that comprise the tiny sliver of the Western business community involved in the trade. We are familiar with the names of those businessmen who are most heavily engaged in trade with the Soviets. They have been providing advice to key Executive and Congressional managers for years with respect to what is best for our national interest vis-a-vis the Soviets. Their views are taken very seriously and often are incorporated into US and NATO policies.

Can we trust the business community to distinguish between their personal financial gain and our security interests and to display objectivity? In a recent article, George F. Kennan writes: "Never were American relations with Russia at a lower ebb than in the first 16 years after the Bolshevik seizure of power in 1917. Americans were deeply shocked by the violence of the revolution, by the fanaticism and cruelty of the new rules, by their refusal to recognize the debts and claims arising [out of World War I], and above all by [their brazen] world revolutionary propaganda and [their efforts] to promote Communist seizures of power in other countries." [4] It turns out that some Americans didn't share the revulsion and concern over Soviet behavior described by Kennan. In fact, Stalin's first 5-year Plan might have failed if not for the assistance of International General Electric, Ford, Radio Corporation of America, Standard Oil and other U.S. companies who were heavily involved in building the Soviet industrial base well before U.S. recognition of the Soviet Union in 1933. In 1930, roughly 25 percent of all Soviet imports were from the US and in 1931, U.S. manufacturers' short-term credit was the second largest credit source available to Moscow.

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[1] Trade Patterns of the West, 1987, IRR No. 194-December 6, 1988, U.S. Department of State, Bureau of Intelligence and Research.

[2] Ibid.

[3] Even if we assume significantly lower loss estimates it doesn't change the essential conclusion—that for the taxpayer, trade with the Soviets is a losing proposition.

[4] After the Cold War, The New York Times magazine, Sunday, February 5, 1989.

In the decades since then, a small core of business interests scattered throughout the industrial West have maintained close (and presumably profitable) dealings with the Soviets irrespective of the East-West political temperature—in some cases to the detriment of Western security. On the other side of the ledger, the high costs of East-West economic interaction are borne by each and every NATO taxpayer, who de facto underwrite the activities and profits accruing to those few Western businesses involved, by shouldering the tens of billions of dollars in additional taxes for defense.

In sum, we have shown that NATO trade with the Soviet Union is statistically insignificant as a share of our global trade and yet because of Soviet Bloc abuse of the East-West trading relationship, it represents a huge financial and security burden to NATO taxpayers while benefiting a mere handful of businessmen—some of whom are honest but dangerously apolitical and some who are not even honest. It is imperative that NATO begin to reverse the high negatives in the East-West relationship. Soviet compliance with the longstanding human rights demands of the West—while of vital importance—is not sufficient to serve as a fulcrum for NATO decisions regarding expansion of East-West economic relations; nor should the Soviet withdrawal from Afghanistan affect our technology control regime.

Policy Recommendations for 1989 and Beyond

It is, indeed, unfortunate that the gulf between public perceptions and East-West realities is such that pursuit of sound policies in the areas described above would likely be seen by many as a return to "Cold-War" measures, and thus, unpopular. Skepticism among the press and the effects of long-term Soviet disinformation programs and Gorbachev's appeal, particularly on European public opinion, allow for little chance of implementing such policies. That said, I would nonetheless recommend the following steps to begin to rationalize our relations with the Soviet Bloc:

—Because the strength and cohesion of the NATO economies is a vital element in the preservation of Western security, and based on the concerns I have raised earlier, we must not take the passive stance that so-called "non-strategic trade" and other forms of intensified economic interaction with the East Bloc can proceed at random. Nor do we need to undertake economic warfare and press our leverage in attempts to "extract" concessions from Moscow. There is a middle road. Before we move further in introducing Moscow into the fabric of the Western economic system, the NATO governments should demand a meeting with their East-Bloc counterparts, and after carefully explaining why the present modus vivendi for economic interaction is unacceptable, the NATO reps should make it clear that we cannot in good conscience continue to do business with the East under the present rules; either we change the rules or we don't do business. We should tell Moscow that we are prepared to wait patiently, putting all projects and technology transfers on hold, until we observe movement toward the reduction and eventual elimination of Soviet activities that are harmful to our security. Simply put, the Soviets can—at their initiative—develop "transparent mileposts" of structural and behavioral change that we can confirm as irreversible (sharply reduce the numbers of KGB and GRU agents in the West engaged in technology theft and other harmful activities, reduce aggressive microwave intercept programs, silence the disinformation and anti-NATO propaganda and halt the huge, destabilizing Active Measures assault on Western societies). The rationale for this approach is simple: if Moscow wants the same trading relationship with the US as that enjoyed by France or the UK, for example, than its overall relationship to Washington should likewise parallel the benign, friendly nature of our Western partners. Economically embracing someone intent on your destruction or on undermining your effectiveness is a recipe for disaster (or at least higher defense spending). After all, it would be far cheaper for NATO taxpayers to compensate every firm for profits foregone from suspended trade with the East than to continue to subsidize the trickle of business done under present rules through taxes for higher defense spending.

—Regarding technology controls, the COCOM members need to rethink the basis for the technology protection regime, and agree on a more aggressive system for protecting the new conventional technologies that are the wave of the future. The hundreds of firms now violating the accord must be stopped!

—With regard to untied lending to Soviet Bloc borrowers, NATO governments need to develop sound, all-source estimates of the hard currency costs to Moscow of funding its "empire," with the focus on those activities inimical to NATO interests. Such analysis does not presently exist. This information will enhance policy judgments concerning the efficacy of assisting the Soviets in their drive toward double convertibility and lending untied funds to COCOM borrowers and their impact on the cost/benefit equation (which, I presume, would only enlarge the negatives).

—Perhaps a somewhat uniquely-US. priority should be to keep the policymaking activities concerning East-West economic security matters within the confines of the overt Cabinet structure. Over the past eighteen months, there has been a tendency for US policy in this area to be made by a small group of individuals without full participation of the Security Community. The broadest possible Cabinet participation and full adherence to process is needed to develop balanced East-West policy, truly reflective of the national interest.

—The East-West trade policy portfolio should not be overly concentrated in the foreign policy/trade promotion agencies where it tends to be used to score short-term portfolio successes—and particularly as a "sweetener" in connection with Western diplomatic pursuits. The Security Community should have an equal voice. In this regard, NATO taxpayers might logically expect their trade and trade promotion agencies to spend an amount of public time and resources on promoting and facilitating East-West trade that is commensurate with its contribution to our economies (by last count, statistically insignificant at best).

—Finally, the business community should be challenged to justify the overall cost to NATO taxpayers of their relatively marginal business dealings with the Soviet Bloc, the existence of which provides the East the platform from which to acquire sensitive NATO technologies. From the public interest viewpoint, in these days of "no new taxes," tight budgets and a squeeze on Defense, trade with the Soviet Bloc under present rules is not a paying proposition.

Report of the Special Interagency Task Force on Western Lending to the Soviet Bloc

INTRODUCTION

The Task Force, established under the auspices of the National Security Council (NSC) and comprised of representatives of the NSC, Departments of State, Treasury, Commerce, and Defense, the Economic Policy Council (EPC) and the Central Intelligence Agency (CIA), has a mandate to review and evaluate data for Western lending to Soviet Bloc countries, Vietnam, Libya, Cuba and Nicaragua. This report was drafted by the Department of the Treasury and was fully coordinated by Task Force member agencies.

Members of Congress have raised a number of concerns and have called for the phasing out of untied (general purpose) lending by Western institutions to the Soviet Bloc and certain other countries. A concern is that untied, hard currency lending by Western allied sources adds to the Western defense burden by effectively funding the defense build-up of the Soviet Bloc and certain other countries.

The report focuses on bank lending. The attached unclassified tables (1-4) provide data on the size and sources of gross and net Western bank claims on the Soviet Bloc (Bulgaria, Czechoslovakia, German Democratic Republic (GDR), Hungary, Poland, Romania, USSR), Cuba, Vietnam, Libya and Nicaragua. The bank claims data comprise the principal categories of untied debt, including syndicated bank loans, bank-to-bank loans, deposits, and drawings under revolving underwriting facilities and note issuance facilities. Bank claims also include tied debt, i.e., government-guaranteed and other trade-related bank claims. Untied loans also comprise bonds and private borrowing from nonbank entities. While funds are raised by the Bloc through the bond market, bonds are not a financing vehicle used by Cuba, Vietnam, Libya or Nicaragua.

The report also examines borrowing by the Soviet Union and the terms on which Soviet Bloc countries are able to obtain credit.

Summary and Conclusions

—In recent years the debt of the Soviet Union and its Eastern European allies has risen in nominal (unadjusted) terms. However, when looked at in real terms the increase in debt is much less.

—Most of the increase in claims by the West has been due to the dollar's substantial depreciation against other major currencies since 1985, and not new lending. This depreciation has increased Soviet Bloc debt when expressed in dollars.

—A more accurate picture of the level of Soviet Bloc debt should take into account exchange rate changes, as well as Soviet Bloc redeposits in Western banks which have, to a large extent, offer new borrowing.

—Soviet Bloc gross debt to Western banks and other lenders at constant exchange rates increased by only 14 percent or $13 billion during the period between end-1981 and end-1986. Net debt (gross debt less deposits) adjusted for exchange rate change had actually fallen (Table 5).

—The Bank for International Settlements (BIS) estimates that gross borrowing by the Soviet Union from BIS-reporting banks (adjusted for exchange rate changes) has been $8.4 billion in the period 1985–87 (Q3) compared to $14.6 billion on an unadjusted basis. Net repayments in 1987 to official creditors and for officially guaranteed non-bank credits were $2.9 billion, according to BIS/OECD estimates.

—Each of the countries discussed in this report differs substantially in terms of debt levels, borrowing potential, and debt servicing capabilities.

—Poland, for example, is an extremely weak credit and is, therefore, generally unable to obtain new financing. The Soviet Union's external financial position appears adequate and is like, to remain so during the foreseeable future, in the absence of severe external shocks and/or unexpected sharp changes in Soviet policy.

—85 percent of the claims of banks reported to the BIS on the Soviet Bloc are on four countries. 85 percent of the increase in such claims since 1983 is accounted for by the USSR, Hungary and the GDR (Table 2).

—New borrowing by the Soviet Union in 1988 has been largely tied. In contrast, borrowing from 1983 through 1987 had been largely untied (general purpose) borrowing.

—Historically, the Soviet Union has maintained a close relationship with certain Western commercial banks, many of which feel comfortable in assessing the creditworthiness of the Soviet Union Western banks' positive assessment of the Soviet Union stems in part from that country's gold reserves currently valued at over $30 billion.

—There is no clear parallel between the growth of exposure to the Soviet Bloc and the origins of the Latin American debt situation.

—The Soviet Union has recently negotiated several lines of credit from Western sources. These credit lines, amounting to as much $5 to 6 billion, appear to be tied to Soviet purchases of Western equipment and consumer goods. It is not possible to determine whether and/or to what extent these credit lines will be utilize and over what period of time. We have no evidence of Western government involvement that violates the OECD Arrangement on export credits.

—The future holds many uncertainties for each Soviet Bloc country. The U.S. Government will continue to monitor and review Western lending to the Soviet Union and Soviet Bloc countries and wiII continue to consult with our allies on this issue.

Discussion

Tied and Untied Lending.—After examination of published information, we note that Western lending to Soviet Bloc countries has been concentrated among a few borrowers. Western banks' outstanding claims on four countries (USSR, GDR, Hungary and Poland) account for the preponderance of bank claims on the Soviet Bloc reported to the BIS (86 percent at end-1987 per Table 1, BIS semiannual consolidated data series and 85 percent at end-March 1988, per Table 2, BIS quarterly series). Since 1983, the increase in bank claims has been concentrated (88 percent) among three of the four—the USSR, GDR and Hungary (Table 2). The effect of changes in foreign currency exchange rates vis-a-vis the U.S. dollar has overstated (or understated) the actual amount of new borrowing undertaken in non-dollar currencies reflected in the unadjusted data for bank claims outstanding, expressed in dollars (Table 4).

The Organization for Economic cooperation and Development (OECD) estimates that at constant exchange rates, gross debt of the Soviet Bloc to Western lenders increased by only 14 percent or $13 billion during the period between end-1981 and end-1986. Net debt (gross debt less deposits) adjusted for exchange rate changes actually declined (Table 5).

Western bank claims (unadjusted) on the USSR, the principal borrower among the Bloc countries, increased $14.6 billion in the 1985–87 (Q3) period. After adjustment for exchange rate changes, the Bank for International Settlements (BIS) estimates gross borrowing by the USSR from BIS-reporting banks was $8.4 billion (Table 4) . Historically, the Soviet Union has maintained a close relationship with certain Western commercial bank lenders, which have lent funds or arranged large syndications on a fairly consistent basis. These banks appear to be comfortable in assessing the USSR's creditworthiness in part, perhaps, because of Soviet gold reserves of over 70 million ounces, currently valued at over $30 billion, and because of the banks' perception of the Soviet Union's historic caution against borrowing more than can be serviced.

Although complete country-by-country lender data are not available, lending by commercial banks from the Summit seven countries accounts for roughly 70 to 75 percent of loans to Soviet Bloc countries (the percentage would be even higher if

FRG-GDR lending were included). Swiss commercial bank claims add another 4 to 5 percent to the overall total. The largest lenders ranked by size of outstanding bank claims are the FRG, followed by Japan (whose rate of growth in lending has been the highest in 1986 and 1987), France, the U.K., Italy, Switzerland, the US and—based on estimates—Canada (there are no published data available for Canada). Table 1 shows the details that are publicly available from individual lender countries, in nominal terms.

Net repayments in 1987 to official creditors and for officially-guaranteed nonbank credits were $2.9 billion according to BIS/OECD estimates (Table 6). According to several sources, increased reliance on nonofficial borrowing prior to 1988 had reflected (1) the USSR's desire to avoid borrowing at the high OECD-consensus rate for official and of officially-guaranteed credits and (2) the private market's more positive evaluation of the Soviet Union and certain other Soviet Bloc countries as credit risks. The resulting increased claims not guaranteed by official export agencies may diminish commercial bank willingness in the future to take on new credits at thin margins.

Publicized borrowings by the Soviet Union in 1988 to date have been largely officially-guaranteed, export-related borrowings, as shown in the following data compiled by the International Financing Review (IFR): $50 million (ECGD-backed), Midland Bank; $193 million (ECGD-backed), Morgan Grenfell; $50 million (ECGD-backed), Morgan Grenfell; $50 million, Abu Dhabi Commercial Bank and Abu Dhabi Investment Co.; $150 million, Credit Lyonnais; Dkr 193 million (Buyer credit) Privatbanken; $11 million (ECGD-backed) National Westminster Bank and Moscow Narodny. In addition, a consortium of West German banks recently concluded a DM3 billion line of credit to finance the modernization of USSR consumer goods and food industries; German firms are expected to receive the major share of the orders. Mediocredito Centrale also signed a $700 million line of credit with the Soviets to finance exports of Italian consumer goods and equipment to the Soviet Union.

Generally speaking, however, the Soviet Union's borrowing from banks until 1988 had been largely untied, meaning that it is not directly linked to the purchase of projects, goods or services. There are no precise estimates of the extent of untied bank claims for the Soviet Union or other countries but information describing publicized loans to the Soviet Union is the basis for a CIA tabulation updated by Treasury (Table 7). The tabulation indicates that the percentage of untied loans has been declining since 1985 and in 1988, through May, shows a preponderance of tied loans. No similar tabulation has been done for the ocher Bloc countries.

Another partial indicator of the extent of untied bank claims on the Soviet Union and other Bloc countries can be derived from the BIS/OECD statistics of external indebtedness. Officially-guaranteed external bank claims at the end of 1987 were 14 percent of total bank claims on the Soviet Union as shown in the attached Table 8. The largely untied residual figure (86 percent) for bank claims also includes suppliers' credits or other trade-related credits that are not subject to official insurance or guarantees and thus overstates the extent to which bank claims are untied. (Similarly, the non-bank credits included in the table exclude trade-related credits not officially insured or guaranteed and understates the amount of tied lending to Soviet Bloc countries by nonbanks.)

Securities Market

According to the OECD, recent Soviet Bloc bond offerings have been undertaken by Hungary—about $600 million in 1987—and the Soviet Union, which entered the bond markets this year with a 100 million Swiss Franc offering and a DM500 million issue in West Germany. With the exception of Czechoslovakia, the other countries have not been active participants in the foreign or international bond markets in recent years.

U.S. law effectively prohibits an issue of securities by the Soviet Union in the United States. The Johnson Debt Default Act of 1934 (the "Act") provides penalties for anyone in the United States who makes an untied loan to or purchases or sells the obligations of a foreign government that is in default on its obligations to the U.S. Government. The penalties also apply to lending by banks in the United States.

Johnson Act Exceptions

There are important exceptions to the Johnson Act. The Attorney General has ruled in several opinions that banking activities associated with trade financing and export transactions are permissible under the act. Banks can thus deal with, for example, the Soviet Union, in normal export credits, lines of bank credit (including letters of credit and bankers' acceptances), barter arrangement, and drafts, checks and other ordinary aids to banking and credit. Also pursuant to an opinion of the

Attorney General, the act does not apply to foreign branches or subsidiaries of U.S. banks.

In addition, the act does not apply to members of the International Monetary Fund (IMF) and the World Bank. When Poland joined the (IMF) and World Bank, it was no longer subject to Johnson Act restrictions. The act currently applies to the Soviet Union, the GDR and Czechoslovakia.

The act is inapplicable to Federal corporations such as the Export-Import Bank of the United States (Eximbank) and the Commodity Credit Corporation (CCC), and persons or corporations participating in any transactions engaged in by the Eximbank or the CCC.

Borrowing Terms

Terms on commercial loans to the Soviet Bloc reflect the judgment of competing banks regarding the creditworthiness of the borrowers. Large syndicated Euromarket loans have economies of scale that are reflected in the rates charged. Rates charged to Soviet Bloc borrowers have sometimes been lower than rates received by certain individual LDC borrowers and certain domestic borrowers in the United States. The OECD indicates an average margin of 24 basis points over LIBOR for syndicated credits to the Soviet Bloc in 1987, compared to 69 basis points for LDGs and 34 basis points for the OECD area.

The slightly higher average spreads charged to all OECD borrowers in 1986 and 1987 (Table 9) in part reflect the fact that there is considerable diversity among the wide range of sovereign and commercial borrowers from the OECD countries. Thus, the average spread on bank loans to OECD countries reflects loans made at higher cost to less attractive OECD borrowers as well as at fine spreads to top quality borrowers.

Average spreads on bank loans to the Soviet Bloc have declined from 118 basis points in 1983 to 24 basis points in 1987. The explanation for the rapid decline in spreads charged to Soviet Bloc (and some other) borrowers reflects several factors. These include the perception of relatively greater creditworthiness vis-a-vis Latin American sovereign borrowers, who largely withdrew from the voluntary syndicated bank market from 1983 onwards. In addition, many prime corporate borrowers in the OECD area moved away from syndicated loans, transferring borrowing to the international bond markets or issuing their own commercial paper (syndicated loans accounted for 55 percent of total borrowing on international capital markets in 1982, but fell to 14 percent in 1986 and 23 percent in 1987). In general, there was a relative lack of attractive international for syndicated bank loans. Borrowers deemed to be creditworthy could demand fine terms from commercial bank lenders.

A comparison of only interest rates or interest rate spreads can be misleading because they do not capture all the costs of borrowing. A comparison of all-in costs, including fees, is not possible, but it is believed that such a comparison would show Soviet Bloc borrowing terms to be somewhat less favorable than is indicated by interest rate spreads.

Recent commentary in the financial press and by the OLCD suggests that the relatively attractive terms that Soviet Bloc countries have enjoyed could harden in reaction to bankers' expectations of rising debt and in some cases unfavorable economic developments. For example, the 1988 $150 million syndicated bank credit to the Soviet Union had a 3/16 (19 basis points) margin over LIBOR, which would compare to margins charged of just 1/8 basis points) on other Soviet and Czechoslovak borrowings in 1987.

There is no subsidization of commercial bank lending or direct government lending for nonagricultural or nonmilitary goods and services by Western governments except as agreed under the OECD's Export Credit Arrangement for official credits and guarantees.

Officially Supported Export Credits

The OECD Export Credit Arrangement (the "Arrangement") establishes terms and conditions under which participating countries provide official support for national exports. These guidelines apply to nonagriculture nonmilitary exports with a repayment term exceeding 2 years.

Under the Arrangement, borrowing countries are classified into three categories according to per capita GNP. Category I is made up of industrialized countries, Category II is the middle-income countries, and Category III is the lower-income countries. For standard export credits, only Category III credits entail a significant degree of subsidization. A repayment term of up to 10 years is permissible. Nicaragua and Vietnam are Category III countries.

Category II minimum interest rates are generally quite close to market rates, i.e., 105 to 155 basis points over long-term government bond yields. However, when

market rates are rising there could be some subsidy in Category II rates since adjustments to the Arrangement rates will always lag market developments. The maximum repayment term is 8.5 years, with 10 years permitted under certain circumstances. Bulgaria, Hungary, Poland, Romania, and Cuba are Category II countries. Category I rates have been at or above market rates in most currencies.

Effective July 15, 1988, however, there is no subsidization permitted in any currency for Category I countries. Official direct lending in support of exports will be at proxies for market rates—Commercial Interest Reference Rates (CIRRS), or guarantees of commercial loans only. The maximum repayment term is 5 years without prior notification to competitor OECD governments, and up to 8.5 years with prior notification. Czechoslovakia, the GDR, the USSR and Libya are Category I countries.

The attached Table 10 summarizes the current minimum interest rates and maximum repayment terms for Soviet Bloc countries permitted under the Arrangement as of July 15, 1988. Minimum interest rates are adjusted in July and January if there is sufficient change in the long-term government bond yields of the SDR basket countries.

On average, 11 percent of outstanding export credits supported by participants in the Arrangement are to council for Mutual Economic Assistance (CMEA) countries. This percentage varies considerably by country, with the U.S. having a relatively low percentage due to restrictions on Eximbank lending to many Soviet Bloc countries. Czechoslovakia, the GDR and the USSR receive the major share of Category I credits exceeding 5 years extended by OECD countries. (The Eximbank is legislatively prohibited from financing exports to Bulgaria, Czechoslovakia, the GDR, the USSR, Romania, Cuba, Libya, Nicaragua, and Vietnam.)

The Arrangement also establishes rules for the use of tied aid—or concessional—export credits. In March 1987 an agreement was reached that significantly increased the cost of tied aid credits, making such credits very expensive to use for trade promotion. As of July 15, 1988, a country using tied aid credits for trade promotion would effectively have to give away about 35 percent of the value of the export. A review of recent tied aid credit notifications suggests that generally Soviet Bloc countries do not receive such credits.

Contrast with Latin American Debt

There is no clear parallel between the growth of exposure to the Soviet Bloc and the origins of the Latin American debt situation. Depending upon the country concerned, U.S. banks held between 30 and 40 percent of the commercial bank claims in Latin America; in some of the countries, hundreds of U.S. banks were involved. The current situation in terms of lending to the Soviet Bloc is quite different with regards to the macroeconomic setting, the economic situation of individual countries, the heightened awareness of individual banks to the risks of sovereign lending, increasing regulatory constraints, and the different magnitudes involved.

U.S. bank claims against the Soviet BLoc have been reduced steadily over the past few years. U.S. banks' share of BIS claims on the Soviet Bloc is about two percent of the total, and only a relatively few U.S. banks are involved. The bulk or lending has come from Western Europe—particularly Germany and France—and Japan. Apart from the fact that U.S. bank claims on the Soviet Bloc are quite small, total gross Bloc indebtedness to banks is only about as large as the global bank debt of Mexico or Brazil and much lower than that of Latin America in the aggregate.

Finally, net BIS bank exposure to the entire Soviet Bloc is only roughly $50 billion, a third of which is on the USSR, whose external financial situation is satisfactory. (Institutional Investor magazine in its annual country creditworthiness survey, ranks the USSR 22nd out of 109 countries. This puts it just after New Zealand, but ahead of countries such as Saudi Arabia and Kuwait in the survey.) Where there are credit concerns, BIS banks have either stopped lending altogether (Poland, Cuba), or have shown increasing resistance (Hungary). In one case Romania policy of debt reduction by the country itself is being aggressively pursued.

Outlook

Looking ahead, published commentary summarized in the International Financing Review (IFR) (July 9) suggests future Soviet financing needs in the range of $20 to $40 billion over the medium term. The Brookings Institution estimates that "given the Soviets" hard currency debt levels they have the capacity to borrow up to $15 billion between now and 1990 if they want to (Institutional Investor, May, 1988). An American Sovietologist quoted in the IFR (July 9, 1988) estimates that USSR external borrowings in the aggregate over the next 5 years is likely to be $7.5 billion, in line with Soviet borrowing over the last few years.

Bank of America, Vienna, also predicts that given the outlook for additional borrowing, spreads on lending to the Soviets could increase. It estimates an increase to "as much as 50 basis points above LIBOR—a doubling of current levels" (IFR, July 9, 1988).

A limited number of U.S. banks have been involved in lending to the Soviet Bloc. It is unlikely that a large number of U.S. banks would become involved because of the relatively low spreads and potential political criticism.

This report represents an assessment of the trends in the Soviet Bloc's borrowing and indebtedness. While the situation varies considerably among individual countries, and the future holds many uncertainties for each country, the Soviet Union is expected to remain the most active borrower in absolute terms among Bloc countries, and the best credit risk. Recent reports of the Soviet Union arranging lines of credit indicate continued interest in Western financing for trade purposes. However, it is impossible to determine whether and/or to what extent these credit line will be utilized, and over what period of time. The U.S. Government will continue to monitor and review Western lending to the Soviet Bloc and will continue to consult with Western allies on this issue.

Outstanding Bank Claims on Soviet Bloc Countries, Albania, Cuba, Vietnam, Libya and Nicaragua

$ millions

	Albania	Bulgaria	Czech.	G.D.R.	Hungary	Poland	Romania	U.S.S.R.	Total (1)	Cuba	Vietnam	Libya	Nicaragua
1980													
BIS Banks (2)	2	2,876	3,545	9,928	8,002	16,173	5,776	13,438	59,741	1,834	510	686	721
U.S. Banks	—	425	170	1,154	907	2,085	329	482	5,552	—	—	216	450
U.K. Banks	—	471	426	1,739	825	2,146	844	2,516	8,967	208	38	N.A.	67
Swiss Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	3,082	N.A.	N.A.	N.A.	N.A.
French Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
German Banks (3)	N.A.	475	130	N.A.	1,168	3,002	574	2,264	7,615	N.A.	55	31	N.A.
Italian Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Japanese Banks (4)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
1981													
BIS Banks (2)	—	2,371	3,319	10,729	7,714	15,228	5,067	16,278	60,706	1,572	432	1,075	792
U.S. Banks	17	245	213	983	1,115	1,962	378	478	5,391	—	—	136	423
U.K. Banks	—	355	426	1,643	864	2,070	854	2,542	8,754	185	23	N.A.	90
Swiss Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	2,814	N.A.	N.A.	N.A.	N.A.
French Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
German Banks (3)	N.A.	404	120	N.A.	851	3,046	410	1,925	6,756	N.A.	38	33	N.A.
Italian Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Japanese Banks (4)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
1982													
BIS Banks (2)	—	2,067	2,848	8,859	6,757	13,910	4,243	14,596	53,280	869	376	1,004	814
U.S. Banks	—	192	171	633	587	1,513	282	229	3,957	—	—	93	404
U.K. Banks	—	324	367	1,498	802	1,749	851	2,297	7,888	178	—	N.A.	94
Swiss Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	2,317	N.A.	N.A.	N.A.	N.A.
French Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
German Banks (3)	N.A.	373	132	N.A.	659	2,858	356	1,759	6,137	N.A.	36	18	N.A.
Italian Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Japanese Banks (4)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.				
1983													
BIS Banks (2)	—	1,716	2,748	8,448	7,001	10,934	3,857	15,582	50,286	1,023	311	965	643
U.S. Banks	—	127	157	485	904	1,067	211	154	3,105	—	—	22	322
U.K. Banks	—	283	303	1,272	746	1,471	719	2,344	7,138	161	—	N.A.	100
Swiss Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	1,914	N.A.	N.A.	N.A.	N.A.
French Banks (5)	N.A.	N.A.	N.A.	1,581	N.A.	1,905	N.A.	4,253	11,405	N.A.	N.A.	N.A.	N.A.
German Banks (3)	N.A.	350	180	N.A.	602	2,077	278	2,222	5,708	N.A.	31	16	N.A.
Italian Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Japanese Banks (4)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	4,988	N.A.	N.A.	N.A.	N.A.
1984													
BIS Banks (2)	3	1,530	2,390	8,434	6,763	8,687	3,074	15,787	46,668	1,027	293	925	633
U.S. Banks	—	100	157	372	765	693	202	143	2,432	—	—	40	225
U.K. Banks	—	208	283	957	812	1,146	609	2,316	6,351	126	—	N.A.	108
Swiss Banks	1	127	106	264	171	333	110	207	1,319	75	—	22	14
French Banks	N.A.	N.A.	N.A.	1,430	N.A.	1,477	N.A.	3,477	10,000	N.A.	N.A.	N.A.	N.A.
German Banks (3)	N.A.	350	180	N.A.	602	2,077	278	2,222	5,708	N.A.	31	16	N.A.
Italian Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Japanese Banks (4)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	4,988	N.A.	N.A.	N.A.	N.A.

	Albania	Bulgaria	Czech.	G.D.R.	Hungary	Poland	Romania	U.S.S.R.	Total	Cuba	Vietnam	Libya	Nicaragua
1985													
BIS Banks (2)	82	2,960	2,654	10,259	8,840	9,854	3,022	22,022	59,661	1,607	395	926	523
U.S. Banks	—	114	107	310	606	550	159	114	1,960	—	—	56	91
U.K. Banks	—	434	299	928	661	1,136	611	3,247	7,316	155	—	N.A.	98
Swiss Banks (6)	7	219	166	272	248	402	111	678	2,103	110	2	28	82
French Banks	N.A.	N.A.	N.A.	1,759	N.A.	1,746	N.A.	5,184	10,858	N.A.	N.A.	N.A.	N.A.
German Banks (3)	N.A.	646	571	1,797	1,376	3,084	381	3,864	11,718	N.A.	37	502	N.A.
Italian Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Japanese Banks (4)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	7,868	N.A.	N.A.	N.A.	N.A.
Sep. 1986													
Japanese Banks (6)	N.A.	592	413	2,223	2,738	664	165	3,473	10,299*	180	140	8	17
1986													
BIS Banks (2)	19	4,177	3,120	12,249	9,954	10,733	2,805	28,685	71,757	2,572	439	698	503
U.S. Banks	—	112	62	282	346	469	140	95	1,506	—	—	13	66
U.K. Banks	—	457	26	936	589	1,119	558	3,346	7,031	187	—	N.A.	88
Swiss Banks (7)	1	357	180	601	242	464	117	1,149	2,911	153	2	16	91
French Banks	N.A.	N.A.	N.A.	1,782	N.A.	1,673	821	6,057	11,820	N.A.	N.A.	N.A.	N.A.
German Banks (3)	N.A.	1,010	807	2,403	1,633	3,747	407	4,938	14,946	N.A.	56	620	N.A.
Italian Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Japanese Banks (4)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	12,049	N.A.	N.A.	N.A.	N.A.
Jun. 1987													
BIS Banks (2)	13	4,631r	3,648	12,988	11,073	10,856	2,488	29,076	75,028r	2,433	440	509	471
U.S. Banks	—	88	45	253	345	425	113	234	1,503	—	—	11	57
U.K. Banks	—	469	308	863	589	1,148	505	3,206	7,088	187	—	N.A.	84
Swiss Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
French Banks	N.A.	N.A.	N.A.	2,015	N.A.	1,753	N.A.	6,158	12,317	N.A.	N.A.	N.A.	N.A.
German Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Italian Banks (8)	N.A.	197	121	794	378	1,178	152	N.A.	5,673	N.A.	N.A.	N.A.	N.A.
Japanese Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Sep. 1987													
Japanese Banks (6)	N.A.	1,132	565	2,912	3,391	674	81	4,609	13,367*	192	170	N.A.	16
1987													
BIS Banks (2)	62	5,254	4,227	14,961	12,442	11,909	2,486	32,206	83,542	2,717	525	554	461
U.S. Banks	—	88	41	148	380	386	117	164	1,324	—	—	10	43
U.K. Banks	—	411	319	981	602	1,276	502	3,117	7,208	226	—	N.A.	83
Swiss Banks (9)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
French Banks (9)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
German Banks (3)	N.A.	1,340	1,017	2,678	2,592	4,340	391	5,421	17,779	N.A.	67	979	N.A.
Italian Banks	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.
Japanese Banks (4)	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	N.A.	15,382	N.A.	N.A	N.A	N.A

N.A. not available. r revised.
(1) The BIS presentation of data for Eastern Europe includes data for Albania in the total. Albania is not a member of the Soviet Bloc.
(2) BIS reporting countries not included separately in the table are: Austria, Belgium-Luxembourg, Denmark, Finland, Ireland, Netherlands, Norway, Spain, Sweden, Canada, Bahamas, Bahrain, Cayman Islands, Hong Kong, Netherland Antilles and Singapore.
(3) FRG transactions with GDR are considered to be "inner German" transactions and are excluded except for loans from foreign subsidiaries of German banks.
(4) Data cover medium and long-term loans only and include Euroyen loans.
(5) Figure for total includes Bulgaria, Czechoslovakia, Hungary, and Romania from 1983 to 1985 and in 1987. In 1986, it excludes Romania.
(6) Figures represent official data, which was leaked and not officially published.
(7) Data for 1985 and 1986 are not strictly comparable with that of earlier years.
(8) Figure for total includes Albania and the U.S.S.R.
(9) Comparable data for the year 1987 not yet available.
* Excludes Yugoslavia.

Note: U.K., Swiss, French, Italian and U.S. data are on a consolidated basis, including overseas offices. Data for Germany are unconsolidated, but are aggregated for banks in Germany, foreign branches and foreign subsidiaries of German banks.

Note: End of year exchange rates used by Treasury to convert French, German, Japanese and Italian currencies into dollars.

Note: Data on Canadian lending to the Eastern Bloc and other specified countries are not published, nor made available to the public.

SOURCES: Country Exposure Lending Survey; BIS - Maturity Distribution of International Bank Lending; Bank of England's "Quarterly Bulletin"; Swiss National Bank; Bank of France; Bank of Italy's "Economic Bulletin"; Japanese Ministry of Finance published data; Japan Bond Research Institute in Country Risk Publication; Deutsche Bundesbank; Statistical Supplements to Monthly Reports, Series 3 (Balance of Payments statistics).

IMB
7/21/88

External Position of BIS-Area Banks on Soviet Bloc Countries and Albania

$ million

	Dec. 1983	1984 change	Dec. 1984	1985 change	Dec. 1985	1986 change	Dec. 1986	1987r change	Dec. 1987r	Mar. 1988
Albania										
Assets	2	(1)	1	6	7	35	42	41	83	113
Liabilities	52	(22)	30	(14)	16	(1)	15	85	100	119
Net Position	(50)	21	(29)	20	(9)	36	27	(44)	(17)	(6)
Bulgaria										
Assets	1,757	(180)	1,577	1,299	2,876	1,211	4,087	1,272	5,359	5,891
Liabilities	1,166	262	1,428	663	2,091	(710)	1,381	(295)	1,086	909
Net Position	591	(442)	149	636	785	1,921	2,706	1,567	4,273	4,982
Czechoslovakia										
Assets	2,727	(315)	2,412	258	2,670	458	3,128	1,107	4,235	4,342
Liabilities	936	67	1,003	8	1,011	206	1,217	381	1,598	1,657
Net Position	1,791	(382)	1,409	250	1,659	252	1,911	726	2,637	2,685
G.D.R.										
Assets	8,388	(80)	8,308	1,941	10,249	1,325	11,574	2,501	14,075	14,737
Liabilities	3,389	1,145	4,534	1,993	6,527	928	7,455	1,538	8,993	9,474
Net Position	4,999	(1,225)	3,774	(52)	3,722	397	4,119	963	5,082	5,263
Hungary										
Assets	7,103	(217)	6,886	1,844	8,730	1,265	9,995	2,374	12,369	12,038
Liabilities	1,308	225	1,533	744	2,277	(136)	2,141	(626)	1,515	1,260
Net Position	5,795	(442)	5,353	1,100	6,453	1,401	7,854	3,000	10,854	10,778
Poland										
Assets	11,281	(2,359)	8,922	1,262	10,184	862	11,046	1,137	12,183	11,668
Liabilities	1,244	303	1,547	48	1,595	126	1,721	1,273	2,994	2,987
Net Position	10,037	(2,662)	7,375	1,214	8,589	736	9,325	(136)	9,189	8,681
Romania										
Assets	3,917	(731)	3,186	(146)	3,040	(149)	2,891	(349)	2,542	1,975
Liabilities	511	130	641	(272)	369	270	639	748	1,387	761
Net Position	3,406	(861)	2,545	126	2,671	(419)	2,252	(1,097)	1,155	1,214
Soviet Union										
Assets	16,222	418	16,640	6,086	22,726	6,353	29,079	4,268	33,347	34,076
Liabilities	10,924	417	11,341	1,721	13,062	1,780	14,842	(708)	14,134	14,210
Net Position	5,298	1	5,299	4,365	9,664	4,573	14,237	4,976	19,213	19,866
Total										
Assets	51,972	(3,767)	48,205	12,534	60,739	11,365	72,104	12,372	84,476	85,115
Liabilities	19,730	2,398	22,128	4,909	27,037	2,441	29,478	2,473	31,951	31,486
Net Position	32,242	(6,165)	26,077	7,625	33,702	8,924	42,626	9,899	52,525	53,629

Note: There were breaks in series from 1983 to 1987, however, this table is constructed to indicate the largest universe of lenders to the Eastern Bloc countries. The above figures are not adjusted for exchange rate changes.

SOURCE: BIS-International Banking and Financial Market Developments (first quarter 1986, first quarter 1987, fourth quarter 1987 and first quarter 1988.

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9/16/88

External Position of BIS-Area Banks on Selected Countries

$ million

	Dec. 1983	1984 change	Dec. 1984	1985 change	Dec. 1985	1986 change	Dec. 1986	1987r change	Dec. 1987r	Mar. 1988
Cuba										
Assets	1,215	(83)	1,132	477	1,609	498	2,107	414	2,521	2,417
Liabilites	112	(12)	100	128	228	(112)	116	83	199	185
Net Position	1,103	(71)	1,032	349	1,381	610	1,991	331	2,322	2,232
Vietnam										
Assets	307	(24)	283	108	391	51	442	81	523	531
Liabilites	59	(19)	40	5	45	69	114	(12)	102	87
Net Position	248	(5)	243	103	346	(18)	328	93	421	444
Libya										
Assets	1,390	(148)	1,242	(67)	1,175	(283)	892	(180)	712	579
Liabilites	4,085	(596)	3,489	2,526	6,015	122	6,137	745	6,882	6,190
Net Position	(2,695)	448	(2,247)	(2,593)	(4,840)	(405)	(5,245)	(925)	(6,170)	(5,611)
Nicaragua										
Assets	663	(109)	554	229	783	(219)	564	(66)	498	486
Liabilites	182	(53)	129	355	484	(423)	61	(32)	29	39
Net Position	481	(56)	425	(126)	299	204	503	(34)	468	447

Note: There were breaks in series from 1983 to 1987, however, this table is constructed to indicate the largest universe of lenders to the selected countries above. These figures are not adjusted for exchange rate changes.

SOURCE: BIS-International Banking and Financial Market Developments (first quarter 1986, first quarter 1987, fourth quarter 1987 and first quarter 1988.

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9/16/88

Table 3

The Evolution of Reporting Banks' Claims vis-a-vis Eastern Europe, 1982-87

$ billions

	Bulgaria	Czech.	G.D.R.*	Hungary	Poland	Romania	U.S.S.R.	Total (1)
In current dollars								
1982-84	-0.7	-1.1	-2.4	-1.2	-6.7	-2.0	-0.5	-15.5
1985-87 (2)	3.1	1.3	4.2	3.9	2.2	-0.8	14.6	28.3
In constant dollars (3)								
1982-84	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.3	-5.8
1985-87 (2)	1.8	0.4	1.7	1.4	-1.3	-1.6	8.4	10.9
Currency composition:								
1985-87 (4)								
US dollar	2.0	0.2	1.4	-0.1	0.1	-0.6	4.5	7.5
Deutsche Mark	0.3	0.2	0.4	0.9	-0.2	-0.4	1.0	2.2
Swiss franc	-0.6	---	-0.1	-0.3	-0.3	-0.5	0.1	-1.7
Japanese yen	0.1	---	---	1.0	---	---	0.8	1.9
Others	---	---	---	-0.1	-0.9	-0.1	2.0	1.0
Total	1.8	0.4	1.7	1.4	-1.3	-1.6	8.4	10.9

* Excludes positions of banks located in the Federal Republic of Germany vis-a-vis the German Democratic Republic.
(1) Includes Albania and residual items.
(2) To end-September 1987 only
(3) Changes at constant end-of-quarter exchange rates.
(4) To end-September 1987 at constant end-of-quarter exchanges rates.
n.a. not available --- indicates zero

SOURCE: BIS-International Banking Developments, 3rd quarter 1987

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Table 5

EAST EUROPEAN DEBT IN A CONSTANT CURRENCY
(millions of dollars)

REAL DEBT 1/

	1981	1982	1983	1984	1985	1986
Bulgaria	3162	3130	2808	2739	3856	4912
Czechoslovakia	4598	4254	4084	3841	3786	3969
GDR	15423	13787	13796	13775	14346	15215
Hungary	8699	8352	9120	10236	12084	14065
Poland	25468	25900	29240	30980	30117	30643
Romania	10159	9856	9370	8218	7069	6199
Total Six	67509	65278	68418	69790	71260	75004
USSR	26534	28227	27081	28041	30531	32134
Total Seven	94043	93505	95499	97831	101791	107139

NET REAL DEBT 2/

	1981	1982	1983	1984	1985	1986
Bulgaria	2352	2113	1514	1138	1723	3648
Czechoslovakia	3528	3449	3018	2613	2672	2781
GDR	13273	11756	10124	8611	7800	8608
Hungary	7799	7559	7676	8515	9928	12304
Poland	24708	24877	27849	29195	28459	29014
Romania	9859	9535	8818	7514	6680	5560
Total Six	61519	59289	58999	57587	57263	61916
USSR	18084	17606	14748	14016	15586	16405
Total Seven	79603	76895	73746	71602	72849	78321

1/ Debt adjusted for exchange rate changes.

2/ Gross debt less deposits in BIS-area banks.

Source: OECD

Table 6

Changes in Bank and Trade-related Non-bank Claims
Under Official Programs, 1987
Adjusted for Exchange Rate Movements

$ millions

	— External bank claims —			Non-bank trade-related credits (2)	Total bank and non-bank trade-related claims
	Total (a)	of which: trade-related (1) (b)	Residual (c)	(d)	(b+d)
Albania	35	—	35	(1)	(1)
Bulgaria	670	(59)	729	(56)	(115)
Czechoslovakia	631	(41)	672	(52)	(93)
G.D.R. (3)	996	(425)	1,421	(248)	(673)
Hungary	742	(52)	794	(101)	(153)
Poland	(593)	(278)	(315)	2,153	1,875
Romania	(671)	(50)	(621)	(352)	(402)
Soviet Union (4)	654	(1,382)	2,036	(2,897)	(4,279)
Total	2,464	(2,287)	4,751	(1,554)	(3,841)
Cuba	(55)	(41)	(14)	164	123
Vietnam	(8)	19	(27)	(7)	12
Libya	(200)	57	(257)	(496)	(439)
Nicaragua	(89)	—	(89)	26	26

(1) Trade-related bank claims under official insurance or guarantee.
(2) Credits under official insurance or guarantee, or extended directly to the foreign buyer by the official sector of the exporting country.
(3) Figures exclude claims of the Federal Republic of Germany throughout.
(4) Banking claims shown include, for most reporting countries, claims on the two Comecon banks—the International Bank for Economic Cooperation, a multilateral clearing bank for transferable rouble trade between Comecon countries, and the International Investment Bank, which invests in medium-term development projects in Comecon countries.

SOURCE: BIS/OECD-Statistics on External Indebtedness:
Bank and Trade-related Non-bank External Claims
on Individual Borrowing Countries and Territories

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9/15/88

USSR: Syndicated Loans*

$ millions

	1980	1981	1982	1983	1984	1985	1986	Jan-June 1987	Treasury update Jul-Dec. 1987	Treasury update Jan-May 1988
TOTAL	---	1,047.1	2,381.0	263.1	801.4	1,763.7	2,212.6	1,257.1	330.2	814.2
Untied	---	---	679.1	222.6	708.8	1,443.3	1,596.7	1,015.4	220.0	150.0
Tied	---	1,047.1	1,701.9	40.5	92.6	320.4	615.9	241.7	110.2	664.2
					Percentage Share					
TOTAL	---	100	100	100	100	100	100	100	100	100
Untied	---	0	29	85	88	82	72	72	67	18
Tied	---	100	71	15	12	18	28	28	33	82

* Does not include syndicated loans to the CEMA international banks or Soviet-owned banks in the West.

Note: Table prepared by CIA, updated by Department of Treasury.

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SOURCE: Euromoney

Table 8

Bank and Trade-related Non-bank Claims Under
Official Programs, December 1987

$ millions

	— External bank claims —			Non-bank trade-related credits (2)	Total bank and non-bank trade-related claims
	Total (a)	of which: trade-related (1) (b)	Residual (c)	(d)	(b+d)
Albania	83	—	83	3	3
Bulgaria	5,369	494	4,875	859	1,353
Czechoslovakia	4,241	522	3,719	877	1,399
G.D.R. (3)	14,141	1,205	12,936	1,973	3,178
Hungary	12,370	282	12,088	410	692
Poland	12,201	1,133	11,068	10,797	11,930
Romania	2,562	455	2,107	623	1,078
Soviet Union (4)	33,436	4,650	28,786	6,765	11,415
Total	84,403	8,741	75,662	22,307	31,048
Cuba	2,541	397	2,144	756	1,153
Vietnam	528	56	472	196	252
Libya	712	57	655	1,091	1,148
Nicaragua	505	38	467	182	220

(1) Trade-related bank claims under official insurance or guarantee.
(2) Credits under official insurance or guarantee, or extended directly to the foreign buyer by the official sector of the exporting country.
(3) Figures exclude claims of the Federal Republic of Germany throughout.
(4) Banking claims shown include, for most reporting countries, claims on the two Comecon banks—the International Bank for Economic Cooperation, a multilateral clearing bank for transferable rouble trade between Comecon countries, and the International Investment Bank, which invests in medium-term development projects in Comecon countries.

SOURCE: BIS/OECD-Statistics on External Indebtedness:
Bank and Trade-related Non-bank External Claims
on Individual Borrowing Countries and Territories

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9/13/88

SPREADS ON INTERNATIONAL BANK LOANS

(basis points)

	1981	1982	1983	1984	1985	1986	1987	1988 (1)
OECD area	58	56	65	55	46	16	34	27
Eastern Europe	62	103	110	88	55	26	24	—
OPEC	79	94	85	76	80	46	72	72
Other LDCs	104	114	170	144	99	67	69	54
General Average	80	77	115	93	63	40	44	30
Memorandum item:								
Excluding "managed" loans								
— Other LDCs	104	114	76	69	66	67	42	54
— General average	80	77	73	63	49	40	36	30

(1) January-March.

N.B. Weighted average of spreads applied to loans of $30 million and over, with a maturity of more than three years completed or signed during the period. Tax-sparing loans as well as facilities classified under "other international bank credits" are excluded.

AVERAGE MATURITY OF RECORDED EURO-CREDITS

(Years/months)

	1981	1982	1983	1984	1985	1986	1987	1988 (1)
OECD countries	7/8	8/3	7/8	7/4	7/5	6/5	6/2	4/7
Eastern Europe	5/7	4/9	4/5	5/11	7/5	7/9	8/1	—
Oil-exporters	7/9	6/0	7/2	7/7	7/2	7/9	10/2	9/8
Other LDCs	7/9	7/0	7/0	8/11	8/11	8/4	10/11	8/2
Total	7/8	7/7	7/3	7/9	7/9	7/1	7/7	5/1
Memorandum item:								
Excluding "managed" loans								
-- Other LDCs	N.A.	N.A.	N.A.	8/1	8/2	8/4	9/1	8/2
-- Total	N.A.	N.A.	N.A.	7/5	7/7	7/1	7/4	5/1

(1) January-March. N.A. not available

Table 10

OECD Arrangement
Minimum Interest Rates
and
Maximum Repayment Terms
Effective July 15, 1988

Country	Interest Rate 2-5 yrs.	Interest Rate over 5 yrs.	Repayment Term
Albania	9.15	9.65	10 yr.
Bulgaria	9.15	9.65	8.5 yr.
Czechoslovakia	market*		**
GDR	market*		**
Hungary	9.15	9.65	8.5 yr.
Poland	9.15	9.65	8.5 yr.
Romania	9.15	9.65	8.5 yr.
USSR	market*		**
Cuba	9.15	9.65	10 yr.
Libya	market*		**
Nicaragua	8.3	8.3	10 yr.
Viet Nam	8.3	8.3	10 yr.

* direct loans at proxies for market rates (CIRRS) or guarantees of commercial loans

** up to 5 years without notification; up to 8.5 years with prior notification

Prepared Statement of Vladimir N. Pregelj, Specialist in International Trade and Finance

U.S. TRADE RELATIONS WITH THE SOVIET UNION SINCE WORLD WAR II: A CHRONOLOGY

SUMMARY

Since World War II, during which they were characterized by the common goals of their military alliance, trade relations between the United States and the Soviet Union have gone through several periods of restrictiveness as well as relation, reflecting generally the tenor of the political relations between the two countries. The onset of the "cold war" in the late 1940s and the resulting changes in the national security and foreign policy interests of the United States, brought with it a period of high restrictiveness in trade. This has been followed, since the mid-1950's, by a period of, on the whole, gradual relation, interrupted from time to time by episodes of greater restrictiveness in the nature of U.S. sanctions triggered by specific actions of the Soviet Union.

A period of considerable revival of U.S.-Soviet trade relations, reflected in the conclusion of several bilateral trade-related agreements, occurred in the early 197Os. Nevertheless, the restoration of the most-favored-nation status to the Soviet Union, proposed in the same period, was vitiated by the Soviet introduction of a very restrictive emigration policy and the U.S. reaction to it, which made such restoration, together with other trade benefits, contingent on a liberalization of the Soviet emigration policy.

The Soviet invasion of Afghanistan in late 1979 resulted in an array of trade and other economic sanctions against the Soviet Union, a few of which still remain in force.

Similarly, trade sanctions were imposed against the Soviet Union because of its role in the suspension of the independent trade union Solidarity and the imposition of martial law in Poland two years later. Over the several subsequent years, these sanctions, too, were mostly terminated, and a more relaxed trade policy introduced.

CHRONOLOGY

March 1, 1948—United States imposed controls on exports to Europe in order to restrict the flow of strategic goods to East Europe, including the Soviet Union. (Emphasis in primary export control purpose was shifted from (wartime) short supply to ("cold war") national security.)

February 26, 1949—Export control Act of 1949 was enacted, formally stating national security and foreign policy as well as short supply as grounds for export control, and provided for penalties for violations.

January 1950—The Coordinating Committee (COCOM) began functioning as the forum for multilateral control of exports of strategic goods to European Communist countries by Western industrialized nations.

1950's—Very restrictive controls on exports to the Soviet bloc were in effect; virtually every export needed a specific license ("validated license"). This policy was relaxed somewhat in mid-1956, when some exports were permitted under general license.

January 27, 1951—Imports of canned crab meat from the Soviet Union were prohibited under the provisions of section 307 of the Tariff Act of 1930, which prohibits imports of goods produced by convict or forced labor. (See also entry for March 25, 1961.)

June 16, 1951—Section 5 of the Trade Agreements Extension Act of 1951 required the President to suspend as soon as practicable the most- favored-nation (MFN) status of the Soviet Union (and countries under its control). Section 11 of the same Act prohibited the importation of seven types of surplus from the Soviet Union (and China). Because of an trade agreement with the USSR which required a 6-months termination notice, both prohibitions went into force on January 5, 1952. (See also entries for October 11, 1962, and August 23, 1988.)

October 26, 1951—Mutual Defense Assistance control Act of 1951 ("Battle Act") was enacted, giving the President statutory authority for the U.S. participation in the COCOM as well as a mandate to invite other countries to participate in controlling strategic imports to Communist countries. The Act also required termination of all U.S. assistance to countries that permit exports of strategic goods to the Soviet bloc. (See also entry for September 29, 1979.)

March 25, 1961—The prohibition on imports of canned crab meat from the Soviet Union imposed under section 307 of the Tariff Act of 1930 (see entry for January 27, 1951) was revoked.

October 11, 1962—Section 231 of the Trade Expansion Act of 1962 required the President, as soon as practicable, to "suspend, withdraw, or prevent the application of the MFN status to any Communist country. This provision replaced the somewhat less restrictive provision of section 5 of the Trade Agreements Extension Act of 1951 (repealed by section 257(e)(1) of the 1962 Act). (See entries for June 16, 1951, and December 16, 1963.)

December 16, 1963—Section 402 of the Foreign Assistance Act of 1963 amended section 231 of the Trade Expansion Act of 1962 (see entry for October 11, 1962) by permitting those Communist countries to which the MFN treatment was applied at the time of enactment of the 1962 Act, to retain it if the President determines that such treatment would be important to the national interest and would promote the independence of such countries from domination by international communism. (The provision, in practice, did not apply to the Soviet Union.)

January 6, 1964—Title III of the Foreign Assistance and Related Agencies Appropriation Act, 1964, prohibited the Export-Import Bank of the United States from engaging in any credit operations connected with exports to a Communist country unless the President determines that such action would be in the national interest and reports thereon to Congress. This provision was inserted in every subsequent foreign aid appropriation act until, on March 13, 1968 (section 1(c), P.L. 90-267), it was made part of the Export-Import Bank Act itself (section 2(b)(2)) and became permanent law. President Johnson made such a determination on February 4, 1964, with respect to agricultural products from the Soviet Union, which President Nixon, on October 18, 1972, extended to all imports from the Soviet Union. (For later actions limiting and/or suspending the Eximbank's authority for credit transactions in connection with exports to the Soviet Union see entries for January 3 and 4, 1975.) (See also entry for October 15, 1986.)

January 1, 1965—A completely revised format of export controls was put into force without, however, changing their effect. Communist countries were assigned to several country groups, each subject to controls of different restrictiveness, although in some instances the differences were minimal. The Soviet Union was placed in group Y, at the middle level of restrictiveness, where most exports required a validated license, but the policy was not one of outright denying them but of considering them on a case-by-case basis.

Late 1966 to mid-1967—In order to improve trade with East Europe, including the Soviet Union, controls (validated license requirement) were removed on over 1,000 items for export to that area.

February 5, 1969—Imports of nickel granules from the Soviet Union were prohibited because believed to be made from nickel of Cuban origin (see also entries for October 3, 1969, and December 21, 1983).

October 3, 1969—Imports of nickel sulphate from the Soviet Union were prohibited because believed to be made from nickel of Cuban origin (see also entries for February 5, 1969, and December 21, 1983).

December 30, 1969—Export Administration Act of 1969 was approved, stressing the policy of promoting exports to Communist countries while still exercising due regard for national security and foreign policy interests of the United States. The Act required a thorough review of the commodity control List (the list of export items specifying the severity of controls for each item), aimed at eliminating unneeded controls. The review resulted, in mid-1970, in the elimination of the validated license requirement for many exports to European Communist countries, including the Soviet Union.

May 26, 1972—Agreement on the Establishment of a Joint U.S.-U.S.S.R. commercial commission was signed and entered into force. The Commission is composed of government officials of the two countries.

July 8, 1972—Agreement on Soviet Purchases of U.S. Grain (wheat and corn) and extension of U.S. credits therefore was signed and entered into force (to remain in effect "until all the obligations arising from it for both sides are fulfilled").

October 14, 1972—Maritime agreement, including provisions for "equal and substantial sharing" of bilateral bulk cargo and for mutual access to specified ports, was signed with the Soviet Union, and entered into force on November 22, 1972, through December 31, 1975. Replaced by agreement of December 29, 1975.

October 18, 1972—Agreement on the Establishment of the Temporary Purchasing Commission for the Procurement of Equipment for the Rama River Truck complex in the Soviet Union was effected by exchange of letters, and entered into force. Subsequently extended several times through April 18, 1982. At the time of the October 1981 extension, the name of the Commission was changed to "the

Soviet Purchasing Commission." Its operations were closed down as part of "Polish sanctions" (see entry for January 13, 1982) and have not been reopened. The agreement has not been renewed.

—Agreement on Trade Relations (including a reciprocal grant of the MFN treatment) was signed with the Soviet Union, but its entry into force was subject to U.S. legislative approval. Eventually, the "freedom-of-emigration" requirement of the Trade Act of 1974 (see entry for January 3, 1975), under which this agreement could have been implemented, was unacceptable to the Soviet Union, and the agreement was denounced by it as null and void. Under the lend- lease settlement agreement, also signed and effective on this date, lack of the MFN treatment by the United States as provided for in the trade relations agreement, allows the Soviet Union to delay the beginning of the installments to repay the still outstanding $674 million of the $722 million total lend-lease settlement amount until such treatment is extended.

June 22, 1973—Protocol on Expansion and Improvement of Commercial Facilities in Washington and Moscow, and Protocol on the Possibility of Establishing a U.S.-U.S.S.R. Chamber of commerce were signed and entered into force. The latter protocol resulted in the establishment on October 2, 1973, of a joint U.S.-U.S.S.R. Trade and Economic council, whose U.S. membership consists of private firms.

October 3, 1973—Protocol on a Trade Representation of the U.S.S.R. in Washington and a commercial Office of the United States in Moscow was signed and entered into force. A U.S. commercial Office was opened in Moscow in May 1974.

June 29, 1974—Long-Term Agreement to Facilitate Economic, Industrial, and Technical cooperation was signed with the Soviet Union and entered into force for a period of 10 years. (See also entry for June 27, 1984.)

July 19, 1974—Exports of crime control and detection commodities to the Soviet Union (and other Communist countries) were made subject to specific controls.

January 3, 1975—The Trade Act of 1974 (P.L. 93-618) was enacted, containing several provisions affecting trade with Communist countries. Among them, the Soviet Union was affected by the provisions that (a) reaffirmed the existing suspensions of the MFN status but provided for its possible reinstatement to those "nonmarket economy" (NME) countries whose emigration policy and practice are relatively free of arbitrary obstacles and requirements, and extended this "freedom-of-emigration" requirement ("Jackson-Vanik amendment") also to U.S. Government export credits, and credit and investment guaranties (enacted in response to the Soviet Union's imposition, in August 1972, and subsequent relaxation, of very restrictive conditions for emigration of Soviet citizens to non-Communist countries); (b)provided for a special "market disruption" procedure (similar to but less favorable to the affected countries than the normal import-relief procedure) to remedy injurious effects of imports, applicable only to imports from Communist countries; (c) established a special alternative method, applicable only to imports from "State controlled-economy" (SCE) countries, for determining, in antidumping investigations, the foreign market value of a like product on the basis of its production cost in a "surrogate" non-SCE country. The Soviet Union was also included in the list of presumed developed countries ineligible for the benefits of the generalized system of preferences.

Section 613 of the Act limited to $300 million the aggregate amount of loans, guarantees and insurance in connection with exports to the Soviet Union that may be extended without prior congressional approval by a U.S. agency, other than the Commodity Credit Corporation.

January 4, 1975—Section 4 of the Export-Import Bank Amendments of 1974 (P.L. 93-646) required the President to make a separate determination of national interest and report thereon to the Congress for each credit transaction subject to the restriction in section 2(b)(2) of the Eximbank Act (see entry for January 6, 1964) amounting to $50 million or more. Section 8 of the same Act limited to $300 million the aggregate amount of Eximbank's loans and/or financial guarantees for exports to the Soviet Union, and to $40 million the share of this aggregate amount intended for products or services for production, processing, or distribution of fossil fuel energy sources, unless the President determines that a higher amount is in the national interest, submits a report thereon to the Congress, and the Congress approves it by concurrent resolution.

October 20, 1975—Agreement on the Supply of Grain by the United States was signed with the Soviet Union and entered into force (through September 30, 1981); extended for additional 1-year periods on August 5, 1981, and August 20, 1982 (through September 30, 1983). Replaced by agreement of August 25, 1983.

December 29, 1975—Maritime agreement was signed with the Soviet Union, and entered into force on January 1, 1976, for 6 years, replacing the expiring agreement of October 14, 1972. As part of "Polish sanctions" (see entry for December 30, 1981), the 1975 agreement was not renewed upon its expiration.

August 1, 1978—A validated-license requirement (coupled with the policy of denial) was imposed for foreign-policy purposes on exports to the Soviet Union of certain petroleum and gas exploration and production equipment and technical data related thereto. (Some such exports were already subject to national-security controls.) (See also entry for January 21, 1987.)

September 29, 1979—The Export Administration Act of 1979 (P.L. 96-72), a new export control law, was enacted, clarifying many of the existing provisions, and providing clear distinction among the three purposes of export control (short supply, national security, foreign policy), with limitations on the use of foreign-policy controls. It also repealed the Battle Act (see entry for October 26, 1951).

January 7 and 11, 1980—Following the Soviet invasion of Afghanistan in December 1979, trade sanctions ("Afghanistan sanctions") were imposed on the Soviet Union on foreign policy grounds: exports of wheat and corn for the export year October 1, 1979—September 30, 1980, were limited to the 8 million metric cons minimum provided for in the U.S.-Soviet grain agreement of 1975 (see entry for October 20, 1975); exports of many other agricultural products were placed under temporary embargo; validation of new licenses, and outstanding already validated licenses were suspended pending review and revision of export controls on high technology. Most of these measures were in part lifted during the following several months. As part of these sanctions, the United States also suspended the meetings of the Joint U.S.-U.S.S.R. commercial Commission (see entry for May 26, 1972), which were not resumed until May 1985.

January 24, 1980—In the climate of "Afghanistan sanctions," President Carter, by proclamation, imposed a 1-year absolute quota of 1 million short tons on imports of anhydrous ammonia from the Soviet Union, under the authority of the "market disruption" provision (sec. 406) of the Trade Act of 1974 (see entry for January 3, 1975). The action was taken after the President requested (on January 18, 1980) the U.S. International Trade Commission (ITC) to initiate a section 406 investigation of possible market disruption by such imports. Quota was imposed under the emergency provision of the market disruption law and on the basis of an affirmative ITC determination of market disruption in an earlier case involving anhydrous ammonia from the Soviet Union (October 11, 1979), in which, however, the President had determined that remedial action would not be in the national economic interest. After the ITC found (on March 20, 1980) no market disruption in the new case, the imposition of the quota was automatically voided.

February 1, 1980—Embargo on exports of some agricultural products (see entry for January 7 and 11, 1980) was lifted, but they remained under the validated license requirement.

February 4, 1980—Exports of phosphatic rock, phosphoric acid, and phosphatic fertilizers to the Soviet Union were placed under foreign-policy controls (expansion of "Afghanistan sanctions") (see entry for February 25, 1980).

February 25, 1980—Announcement was made of the general policy to deny licenses for exports of phosphatic materials to the Soviet Union (see entry for February 4, 1980).

March 19, 1980—The Department of commerce announced that, the review of export control policy (see entry for January 7 and 11, 1980) having been completed, more restrictive criteria would apply to the control of high technology exports to the Soviet Union.

March 28, 1980—Following President Carter's announcement on February 20, 1980, that the United States would not take part in the 1980 Summer Olympics in Moscow, exports to the Soviet Union of goods and technology for use related to the Olympics, and related payments and transactions, were placed under foreign-policy controls (in effect, embargoed) (expansion of "Afghanistan sanctions").

May 9, 1980—Exports of truck engine assembly lines and their parts and components for the Rama River truck complex (KamAZ) in the Soviet Union were placed under foreign-policy controls, and the general policy to deny licenses for such exports was established as a further expansion of the "Afghanistan sanctions."

July 2, 1980—Regulations came into force permitting the licensing of exports of 8 million metric tons of wheat and corn to the Soviet Union during the last (5th)

year (October 1, 1980—September 30, 1981) of the grain agreement of 1975 (see entries for October 20, 1975, and January 7 and 11, 1980).

April 24, 1981—Embargo on exports to the Soviet Union of grain, other agricultural products, and phosphatic materials was lifted. (See entries for January 7 and 11, and February 25 and July 2, 1980.)

December 30, 1981—As part of sanctions against the Soviet Union in the connection with the imposition of martial law in Poland and suspension of the independent trade union Solidarity in December 1981 ("Polish sanctions"), the processing of applications for validated licenses for exports to the Soviet Union was suspended, and new controls were imposed on exports to the Soviet Union of oil and gas transmission and refining commodities and technology (in addition to those imposed on August 1, 1978, on oil and gas exploration and production equipment). Both measures were, in effect, embargoes. Various other economic sanctions, including refusal to renegotiate the expiring maritime agreement of December 29, 1975, were imposed.

January 13, 1982—As part of "Polish sanctions," the Soviet Purchasing Commission (see entry for October 18, 1972) was closed at the request of the U.S. Government.

March 1, 1982—Range of truck manufacturing equipment for the Rama River plant subject to export controls (see entry for May 9, 1980) was expanded, and controls were extended to equipment for the ZIL ("Likhachev plant").

June 22, 1982—Foreign-policy controls on exports of oil and gas industry equipment to the Soviet Union were extended extraterritorially to apply also to foreign-origin products and technical data exported by U.S.-owned or controlled foreign firms, and to all foreign produced products of U.S.-origin technical data regardless of the nationality of the firm's owner.

November 13, 1982—Export control measures taken on December 30, 1981, and June 22, 1982 (see entries for those dates) as part of "Polish sanctions" were rescinded. (Controls on exports of oil and gas equipment imposed on August 1, 1978, remained in force.)

January 21, 1983—Embargo on trade and other transactions related to the 1980 Summer Olympics in Moscow (entry for March 20, 1980) ("Afghanistan sanctions") was allowed to lapse.

August 25, 1983—Agreement on the Supply of Grain was signed with the Soviet Union and entered into force through September 30, 1988 (replacing the agreement of October 20, 1975). (See also entry for November 28, 1988.)

December 21, 1983—Imports of unfabricated nickel-bearing materials (ore and matte, primary nickel, basic shapes and forms, waste and scrap, nickel-alloy basic shapes and forms, nickel-containing stainless-steel basic shapes and forms) from the Soviet Union were banned because believed to contain Cuban nickel. This action superseded those of February 5 and October 3, 1969.

February 2, 1984—The U.S. International Trade Commission, in an investigation under sec. 406 of the Trade Act of 1974 of possible market disruption by imports of ferrosilicon from the Soviet Union, determined that market disruption did not exist.

June 27, 1984—Long-Term Agreement to Facilitate Economic, Industrial, and Technical cooperation (see entry for June 29, 1974) was extended for 10 years.

May 20-21, 1985—The Joint U.S.-U.S.S.R. commercial Commission met in Moscow for the first time since December 1978. Meetings had been suspended by the United States as part of Afghanistan sanctions (see entry for January 7 and 11, 1980).

July 23, 1985—U.S. Court of International Trade dismissed (for lack of standing, and as a moot action) a suit filed by 35 Members of Congress, a labor union, and 5 other organizations seeking the Department of Treasury to ban, under section 307 of the Tariff Act of 1930, the importation from the Soviet Union of certain products allegedly made by forced labor.

May 30, 1986—The policy of denying licenses for export to the Soviet Union of technical data related to oil and gas exploration and production (see entry for August 1, 1978) was changed to allow consideration of such licenses on a case-by-case basis.

September 18, 1986—Reversing a decision of the U.S. Court of International Trade (July 30, 1985), the U.S. Court of Appeals for the Federal Circuit ruled that countervailing action under section 303 of the Tariff Act of 1930 is inapplicable to nonmarket economy (NME) countries (e.g., the Soviet Union) as a matter of law, and affirmed earlier relevant determinations by the U.S. International Trade Administration. A House-approved provision of the Omnibus Trade and Competitiveness Act of 1988 to extend the applicability of section 303 to NME

countries was dropped in conference (April 20, 1988). Consequently, countervailing action can no longer be taken against imports from NME countries.

October 2, 1986—Embargo on imports of gold coin from the Soviet Union was imposed pursuant to sec. 510 of the Comprehensive Anti-Apartheid Act of 1986 (P.L. 99-440) as amended by P.L. 99-631.

October 15, 1986—Section 8 of the Export-Import Bank Act Amendments (P.L. 99-462) expanded the prohibition of Eximbank's transactions with Communist countries (see entry for January 6, 1964) to apply to "Marxist-Leninist" countries, specifically naming 30 of them (including the Soviet Union, with separate listings for Estonia, Latvia, and Lithuania), but retained the President's authority to waive the ban in the national interest.

January 21, 1987—Foreign policy-based controls on exports of oil and gas industry equipment and technology to the Soviet Union (see entries for August 1, 1978, and May 30, 1986) were removed. Naticnal-security export controls remained in force.

December 4, 1987—Agreement on Trade in Textile Products (cotton sheeting and printcloth) signed with the Soviet Union and entered into force for the period August 1, 1987 through December 31, 1988.

April 11-14, 1988—The Joint U.S.-U.S.S.R. Commercial Commission held its 10th session in Moscow, at which agreement was reached on various measures to develop reciprocal trade. At the conclusion of the session, a Protocol to the Long-term Agreement to Facilitate Economic, Industrial, and Technical cooperation (see entry for June 27, 1984) was signed applying the Agreement to joint ventures and other new forms of business now permitted in the Soviet Union.

August 23, 1988—The Omnibus Trade and competitiveness Act of 1988 (P.L. 100-418) was enacted, containing provisions specifically or generally affecting trade policy toward the Soviet Union: (a) embargo on imports of 7 types of furskins from the Soviet Union (see entry for June 16, 1951) was repealed effective October 1, 1988; (b)in a sense-of-Congress provision, the President was requested to instruct the Secretary of the Treasury to enforce the slave labor provision (section 307) of the Tariff Act of 1930 (see entry for July 23, 1985) against the Soviet Union without delay; (c) certain operative terms and procedural criteria for market disruption action (see entry for January 3, 1975) were defined, and the action itself (which under the Trade Act of 1974 largely followed the procedure for import relief action) remained unchanged while that for import relief was significantly modified; and (d) in antidumping action, the procedure for imports from "State-controlled economy" countries (see entry for January 3, 1975) was, instead, made applicable to "nonmarket economy" countries, the determination of a country as an NME country was given permanent nature (rather than on a case-by-case basis), and in the mandatory order of applicability of alternative methods of determining the foreign market value of a NME country's dumped product, surrogate-country constructed value was placed ahead of surrogate-country actual sales value.

November 28, 1988—Agreement on the Supply of Grain of August 25, 1983, was extended through December 31, 1990.

PRESENT STATUS

Imports from the Soviet Union in general are adversely affected by the denial of the most-favored-nation (MFN; nondiscriminatory) status to the Soviet Union, the principal consequence of which is that they are subject to considerably higher rates of customs duty than those from countries with the MFN status. The restoration of the MFN status is conditioned on the Soviet Union's compliance with the "freedom of emigration" requirements of the Jackson-Vanik amendment to the Trade Act of 1974.

Importation of gold coin from the Soviet Union is prohibited.

Imports from the Soviet Union (as well as those from other Communist countries) are subject to a less favorable safeguard action than those from non-Communist countries. Instead of import relief action under the Trade Act of 1974, market disruption provisions of the same Act, applicable only to Communist countries, can be used, under easier criteria, to remedy temporarily the disruptive effect of imports on the domestic economy. Similarly, an antidumping procedure applicable only to nonmarket economies can result in a higher antidumping duty than would otherwise be the case. On the other hand, countervailing action cannot be taken against imports from the Soviet Union in view of a recent decision of the U.S. Court of International Trade that such action is inapplicable to nonmarket economy (NME) countries (e.g., the Soviet Union) as a matter of law.

Exports to the Soviet Union are subject to controls administered mostly for national-security purposes, although some foreign-policy controls also are in force. National-security controls are applied at a level of restrictiveness (the Soviet Union is in export control country group Y, along with several other European Communist countries) that in effect prevents the exportation of high-technology products to the Soviet Union but allows the export of other items mostly without further formalities. Foreign-policy controls, whose scope goes beyond those imposed on national-security grounds and which in effect amount to an embargo, apply to the exports of truck engine assembly equipment for the Kama River (KamAZ) and ZIL truck manufacturing plants, and to crime control and detection equipment.

Exports to the Soviet Union are adversely affected to some extent also by the restrictions placed by various statutes on U.S. Government export credits and credit guarantees (as well as investment guaranties). The broadest such restriction is the denial of such credits and guarantees contained in the Jackson-Vanik amendment (see above) unless its conditions are complied with.

There are in force also more specific restrictions on U.S. Government export credit operations with the Soviet Union. A limit of $300 million is placed on the aggregate amount of loans, guarantees and insurance in connection with exports to the Soviet Union that may be extended without prior Congressional approval by a U.S. agency, other than the Commodity Credit Corporation.

The Export-Import Bank Act prohibits the Bank from engaging in any export credit transaction for the benefit of a Marxist-Leninist country (specifically including the Soviet Union) unless the President determines that such transaction is in the national interest. A separate determination must be made for any Eximbank loan of $50 million or more, and every determination must be reported to Congress.

The Eximbank Act also limits to $300 million the aggregate amount of Eximbank's loans and/or financial guarantees for exports to the Soviet Union, and to $40 million the share of this aggregate amount intended for products or services for production, processing, or distribution of fossil fuel energy sources, unless the President determines that a higher amount is in the national interest, submits a report thereon to the Congress, and the Congress approves it by concurrent resolution.

Trade relations between the United States and the Soviet Union are promoted through various bilateral agreements, entered into mostly in the early 19709, in force between the two countries, and several bilateral or reciprocal institutions.

The broadest base.for stimulating U.S.-Soviet trade relations is the Long Term Agreement to Facilitate Economic, Technical, and Industrial Cooperation, recently expanded by the addition of a protocol applying the agreement to joint ventures and other new forms of business now permitted in the Soviet Union.

Ajoint U.S.-U.S.S.R. Commercial Commission, composed of representatives of the two Governments, came into being pursuant to the Agreement on the Establishment of a U.S.-U.S.S.R. Commercial Commission. A similar body, the U.S.-U.S.S.R. Trade and Economic Council, composed of representatives of U.S. private and Soviet business-related enterprises, was established on the basis of the Protocol Relating to the Possibility of Establishing a U.S.-U.S.S.R. Chamber of Commerce.

Of more specialized nature are a Protocol Relating to Expansion and Improvement of Commercial Facilities in Washington and Moscow and a Protocol Relating to a Trade Representation of the U.S.S.R. in Washington and a Commercial Office of the U.S.A. in Moscow, both of which have been implemented.

In addition, the Agreement on the Supply of Grain was recently extended through December 31, 1990.

Directly related to trade policy is the still unresolved question of the repayment of the Soviet World War II lend-lease indebtedness. The Agreement Regarding Settlement of Lend-Lease, Reciprocal Aid and Claims, signed and entered into force on October 18, 1972, provided that the Soviet Union would not be required to commence paying its annual installments on the $674 million still outstanding on the $722 million total settlement amount of this debt until the United States had extended to it the most-favored-nation treatment in trade. The trade agreement with the Soviet Union of October 18, 1972, which provided for such treatment, was not implemented because the Soviet Union refused to comply with the procedural requirements of the Jackson-Vanik "freedom of emigration" amendment to the Trade Act of 1974, under which alone the MFN treatment could be extended.

APPENDIX III

List of Participants and Their Affiliations

JOHN P. HARDT, Associate Director for Research Coordination and senior specialist in Soviet economics at the Congressional Research Service. He is also adjunct professor in economics at both Georgetown and George Washington Universities. Dr. Hardt is a frequent traveler to the Soviet Union and Eastern Europe, often with Congressional delegations such as the trade mission of the Ways and Means Committee to Eastern Europe. Economic study delegation to the People's Republic of China (PRC) and the Trade Mission to Asia. He has edited, coordinated, and contributed to many volumes on the economies of the Soviet Union, East Europe, and the PRC for the U.S. Congress.

STUART GOLDMAN, Specialist in Soviet Affairs with the Foreign Affairs and National Defense Division, CRS. BA. from Brooklyn College, MA. from Colgate University and Ph.D. from Georgetown University. Previously worked as an assistant professor of international studies at Penn State. Author of major studies on U.S.-Soviet relations and Soviet foreign and defense policies since joining CRS in 1979.

FRANCIS MIKO, Specialist in Soviet and East European Affairs in the Foreign Affairs and National Defense Division, CRS. B.A. and M.A. in international affairs from the George Washington University Sino-Soviet Institute. Is a graduate of the National War College. He has recently completed studies in Gorbachev's priorities in foreign policy and of reforms in the Soviet Union.

MARK. B. LEVIN, is the Director of the Washington Office of the National Conference on Soviet Jewry. He has worked for the NCSJ since 1980. A graduate of the University of Maryland, Mr. Levin worked for the American Israeli Public Affairs Committee (AIPAC) before coming to the NCSJ. He has traveled extensively on behalf of the National Conference, speaking to various groups on the issue of Soviet Jewry. Mr. Levin has also represented the NCSJ at the last three Democratic and Republican party conventions.

TYRUS COBB, Center for Naval Analysis. Dr. Cobb worked at the National Security Council as Special Assistant to the President for National Security Affairs and later as Director of Soviet and European Affairs for 4 years at NSC. Dr. Cobb his doctoral dissertation at Georgetown on Soviet energy.

HERBERT LEVINE, is a Professor of Economics at the University of Pennsylvania, where he is also the co-director of the Lauder Institute of management and International Studies.

STANLEY SLOAN, Mr. Sloan is Senior Specialist in International Security Policy, Congressional Research Service, Library of Congress. He has previously served as Head of the Europe/Middle East/Africa Section in CRS, as Deputy National Intelligence Officer for Western Europe at the CIA, and as a Member of the U.S. Delegation to the MBFR negotiations. His books include NATO's Future. Toward a New Transatlantic Bargain (1985), Conventional Arms Control and Europe's Future and NATO in the 1990s (ed.) (1989).

TIMOTHY W. STANLEY, Dr. Stanley is a lawyer and an economist who is president and founder of the International Economic Studies Institute. He has combined a career in government—serving at the Pentagon, on the White House Staff, at NATO (as Defense Advisor and Minister at the U.S. Mission) and at the U.S. Arms Control and Disarmament Agency (as Special Representative at the Vienna talks)—with work on international political-economics in nonprofit organizations and academia. Dr. Stanley has taught at Harvard, George Washington and Johns Hopkins (School of Advanced International Studies) universities and is the author or co-author of over half a dozen books and numerous articles, monographs, professional papers and congressional testimony.

ANGELA STENT, Associate Professor of Government of the Russian Area Studies Program at Georgetown University, Washington, DC. Among other writings, she is the author of "From Embargo to Ostpolitik—The Political Economy of West

German-Soviet Relations," and "East-West Technology Transfer— European Perspectives", The Washington Papers No. 75(1980).
EUGENE THEROUX, Partner in the law firm of Baker & McKenzie and has traveled extensively to the U.S.S.R. on behalf of clients of his firm. Mr. Theroux is experienced in the practical and legal aspects of trade and investment projects with nonmarket economies. He is the co-author of Joint Ventures in the Soviet Union: Law and Practice. He is a member of the Legal Committee of the U.S.-U.S.S.R. Trade and Economic Council.
WILLIAM COOPER, Analyst in International Trade and Finance for the Economics Division, CRS. He graduated from George Washington University with an M.A. in economics. Currently, Mr. Cooper works in the areas of International trade, including U.S. trade with Japan and the East Asian newly industrializing countries. His work has also included reports on the omnibus trade bill of 1988.
GARY BERTSCH, Professor of Political Science and Co-director of the Center for East-West Trade Policy at the University of Georgia He is a specialist on U.S. and Western Trade policy toward the Soviet Union and other communist states. His publications include: Est-West Strategic Trade, CoCom, and the Atlantic Alliance, and National Security and Technology Transfer: The Strategic Dimensions of East-West Trade.
STEVEN ELLIOTT, A graduate of the University of Lancaster in the United Kingdom. He is currently finishing a dissertation on business-government relations in U.S. export control policy and is a Research Associate at the Center for East-West Trade Policy at the University of Georgia.
GLENNON J. HARRISON, Analyst in International Trade and Finance in the Economics Divisions, CRS. He received his B.A. from Tulane University and his M.A. (Econ.) and Ph.D. degrees from the University of Manchester in England. Mr. Harrison is the author of CRS studies on the European Community, export controls, telecommunications trade, international debt, and economic sanctions.
DANIEL BOND, Dr. Bond is Vice-President and Chief Economist of the Export-Import Bank of the United States in Washington, D.C. Dr. Bond received his Ph.D. in planning and economics from the University of North Carolina at Chapel Hill. He received undergraduate degrees in line arts and architecture at the Rhode Island School of Design. He also studied at Brown University and Georgia Institute of Technology.
JUDY SHELTON, Research Fellow, The Hoover Institution. She has recently published a book on Western lending to the Soviet Union, "The Coming Soviet Crash."
SARAH CAREY, A member of the U.S.-U.S.S.R. Trade and Economic Council's Legal Committee and a board member of the American Committee on U.S.-Soviet Relations and the Institute of Soviet American Relations. Ms. Carey has practiced law in Washington, D.C. for 20 years. She is a magna cum laude graduate of Harvard College and an honors graduate of Georgetown Law School. In addition to private practice, she has served in the U.S. Department of State and has taught at Georgetown University School of Law.
JULIANA PILON, Executive Director of the National Forum Foundation. Received her doctorate from the University of Chicago. Post Doctoral work at Stanford, and Hoover Institution. Nationally known for reports on Soviet Disinformation, United Nations, East-West Trade and Human Rights. Dr. Pilon author the book "Notes from the Other Side of Night" in which she describes her journey from her native Romania.
SUMNER BENSON, is the Director of the Office of Technology Cooperation and Security in the Office of the Secretary of Defense.
JOHN EDWIN MROZ, is the founder and President of the Institute for East West Security Studies in New York. Dr. Mroz has served as a consultant to the U.S. Department of State, private industry and foundations and conducts regular consultations with European governments and organizations on political and security matters. Dr. Mroz has held a National Science Foundation teaching fellowship at Northeastern University, where he earned his first M.A. in International Studies. After earning another M.A. and M.A.L.D. degree, he completed his Ph.D. residency in 1974 at the Fletcher School.

Senate

Biden, Joseph
Glenn, John
Gore, Albert
Heinz, John
Jeffords, James
Lautenberg, Frank
Levin, Carl
Packwood, Bob
Robb, Charles
Rockefeller, Jay

Simon, Paul	Sharon Waxman
Simpson, Alan	Mike Rosenberg
Worth, Timothy	Steve May
Kay King	William Garner
Pat Buckeit	Ira Wolf
Leon Fuerth	Jonathan Stein
Bill Reinsch	Jo Sherman
Laurie Shultz	Jeff Seabright

Total: 13

Senate Committees

Armed Services	Dick Combs
Communications/Science/Transportation	Ralph Everett
	Linda Morgan
	Chris Van Hollen
Foreign Relations	Jeff Lang
Finance	Harry Broadman
Government Affairs	Judith Davidson
Joint Economic	Richard Kaufman
	George Tyler
	Kent Hughes
Senate Democratic Policy	

Total: 10

House

Downey, Thomas	Jeffery Moore
Foley, Thomas	Jeffery Biggs
Gephardt, Richard	Jo Ellen Urban
Schulze, Richard	Chirachai Punkrarin
Solarz, Stephen	Chris Hill
Wright, James	Marshall Lynam

Total: 6

House Committees

Armed Services	Lou Finch
	Jennifer Iscol
Banking	Bill Danvers
Commission on Security/Coop.in Europe	Jane Fisher
	Robert Hand
Energy and Commerce	William Kitzmiller
	Paul Smith
Foreign Affairs	Sue Eckert
	Bob Huber
	Bill Inglee
	Spencer Oliver
	John Scheibel
	Marty Sletzinger
	Katherine Wilkens
Security/Cooperation/Europe/Mideast	Michael Van Dusen
Joint Economic	John Starrels
Science, Space and Technology	Jim Miller
Ways and Means	Thelma Askey
	Ken Bowler
	Meredith Broadbent
	Janet Nuzum
	Arthur Singleton
	Franklin Phifer

Total: 23

Sister Agencies

GAO	Steve Sternlieb
OTA	Nancy Lubin

Total: 2

Additional

Baker & McKenzie	Eugene Theroux
Brookings	Ed Hewett
Burchette, Heron	Sarah Carey
Carnegie	Kevin Quigley
Department of Commerce	Jack Brougher
	Frank Vargo
Department of Defense	Sumner Benson
	Walter Earle
	John Thomas
E-W Policy/University of Georgia	Steven Elliot
E-4 Section Study	John Mroz
Export-Import Bank	Daniel Bond
	Stephen Glazer
	Thomas Moran
	Frank Record
	Rita Rodriguez
	Don Schwab
Foreign Policy Institution	Carol Hansen
Foreign Relations Council	Alton Frye
Geogetown	Murry Feshbach
	Angela Stent
George Washington University	Henry Nau
International EC Study Institution	Timothy Stanely
Mecator Corporation	Donald Green
NAS	Stephen Merrill
	Mitch Wallerstein
National Council Soviet Jewry	Mark Levin
	Martin Wenick
National Forum Foundation	Juliana Pilon
Naval Analysis	Tyrus Cobb
NSC	Robert Price
Overseas Development Council	Richard Feinberg
	Friedemann Muller
State Department	Richard Johnson
	P.J. Nichols
U.N. Association	Toby Gati
U.S. Treasury	Harvey Shapiro

Total: 37

CRS

William Cooper	Remy Juranas
Stuart Goldman	Francis Miko
John Hardt	Stan Sloan
Glennon Harrison	Joe Whelan
Shelia Heslin	

Total: 9

Grand Total: 100

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